

# Colorado Real Estate Principles

Fifth Edition

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# **Current Legal Issues**



# UNIT 1

## Current Legal Issues

### THE COLORADO REAL ESTATE COMMISSION

The Colorado legislature has established the Colorado Real Estate Commission (the “Commission”) to protect the public in real estate transactions. The Commission adopts rules and issues “position statements” to help enable the laws passed by the legislature and to provide guidance to the real estate community. The Commission is a valuable resource for Colorado brokers, and it is important for all brokers to understand how the Commission works. The five Commission members are appointed for three-year terms. The Commissioners are supported by a staff of administrative and enforcement employees at the Division of Real Estate. One of the ways the Commission meets its mandate to “protect the public” is by handling complaints about real estate brokers.

#### Complaints

When the Commission receives a written complaint about a licensee, the staff of the Commission must investigate it. Members of the public who voice verbal complaints will typically be advised to file a formal written complaint. This is because formal written complaints require investigation and response by the Commission, while verbal complaints do not require the Commission to take action.

Written complaints from the public are investigated, and the complaining party (the “complainant”) receives a response from the Commission in all cases. Licensees (brokers) can also file written complaints against other licensees when rule or law violations are suspected.

Once a complaint is received, the process begins with gathering information. The Commission's investigative staff will review the allegations to determine whether it appears that rule or law violations have occurred. If they do not appear to have occurred, the complaining party will be so advised and the complaint will be dismissed.

Complaints relating to compensation disputes between brokers, complaints based solely on “ethics” violations, and complaints related to generally poor (but legal) business practices will

not be pursued. These issues are outside the purview of the Real Estate Commission. The important question is “Did the broker violate the law or a Commission rule?”

If a violation does appear to have occurred, the staff will contact the licensee being investigated (the “respondent”) to advise the licensee of the complaint and obtain an initial response. The broker must respond to the Commission’s inquiry. Failure to do so is a violation in itself, which is often more serious than the original complaint. Additionally, the employing broker should be notified about the investigation.

Note that before receiving a response, the Commission does not have the right to start a lawsuit, issue a subpoena, or take the firm’s records. Any removal of records or other serious action would occur as part of an ongoing investigation, not prior to the response.

Based on the information gathered from the complainant and the respondent, the Commission staff will make their determination as to whether or not a violation has occurred and will submit its findings to the Commissioners.

At the monthly Commission meeting, the Commissioners will review the complaint and decide the next course of action based on the allegations, staff recommendations, and history of the respondent-broker, if any. Their next action will typically follow one of three directions:

1. If there appears to be no infraction or there is insufficient evidence to support proceeding to a hearing, the Commissioners can dismiss the complaint.
2. If the infraction appears to be minor and there is no history of problems with the respondent-broker, the Commissioners can issue a “Letter of Admonishment” to the broker. This is the lowest form of disciplinary action and serves as a warning to the broker to be careful in the future.
3. If there appears to be a violation serious enough to pursue a hearing, the Commissioners and staff will work in conjunction with other sources including the attorney general’s office to prepare a case. The respondent will be advised of this course of action including the right to counsel and the right to present evidence and witnesses relevant to the matter at the hearing.

If the Commissioners determine that the situation warrants a hearing, the matter is referred to an administrative law judge to hear the case. This is not a jury trial, but evidence and testimony is presented by both sides. The judge hears the case and renders a decision but does not impose the discipline, if any. The judge refers the matter back to the Real Estate Commission to dismiss the case or impose penalties.

If the matter is referred back to the Commission for disciplinary action, a number of options are available to the Commissioners depending on the nature of the situation:

- Public censure: Written reprimand, which is typical for lesser offenses and first-time violations
- Suspension of the broker’s license (normally for a year or less)
- Revocation of the broker’s license
- Fines of up to \$2,500

In addition, in most cases, the Commission will require the broker to obtain additional education in an effort to correct the problem behavior. *All disciplinary actions are made part of the broker’s public record and are posted on the Commission’s website.*

The Commission cannot impose actual damages (money awarded to the complainant). However, negotiations during the hearing process will frequently result in the broker agreeing to restitution in some form. In other words, if the broker agrees to pay the complainant money owed, it is considered restitution. Once agreed to by the broker, it becomes an enforceable agreement.



The Commission does not have authority to investigate or prosecute criminal matters. However, during the investigation process, if it appears that criminal conduct may have occurred, in addition to any license action that is taken, the Commission can refer the matter to the appropriate district attorney for criminal investigation and prosecution.

## Audits

Only employing brokers are allowed to have and maintain trust accounts. The employing broker is required to have a written office policy and to maintain all transaction files for four years. Auditing a brokerage firm's files and trust accounts is part of the Real Estate Commission's obligation to enforce its own rules and related state statutes and is a standard practice. The audit can be a simple routine audit done on a random basis, or the result of a complaint investigation specific to a particular firm. In any case, an audit can be performed by the Commission at any time with or without advance notice to the brokerage firm. In a routine audit, the chosen firm is given notice of the request to audit and the audit is set by appointment. It is standard practice for the Commission to audit a certain random percentage of brokerage firms each year. The Commission choosing to perform an audit on a particular brokerage firm does not mean that the brokerage firm has broken the law.

Audits allow the Commission to examine any of the brokerage firm's files, trust accounts, and other documentation the brokerage firm is required to maintain. Routine audits typically review the trust account, past transaction files, the written office policy, and any property management records. The intent is to ensure compliance with the appropriate rules and to make recommendations for improved operations. While most brokerage firms do not actually look forward to being audited, they typically benefit from the experience. If the audit reveals errors or procedures that risk future violations, suggestions are made by the Commission to correct the problem areas. If serious problems are discovered, the Commission can open an investigation on its own and pursue appropriate disciplinary action.

Audits that are prompted by a complaint can be general in nature or specific to the issue. Such an audit is normally less pleasant than a routine audit and evidence of wrongdoing will be used as part of the investigation and disciplinary process.

## Rule Making, Modifications, and Position Statements

Rules are created for a variety of reasons including changes in law or statute, public protection concerns, public input, and changes in business practices.

When a rule needs to be modified (or a new rule created), a public hearing process is followed to give the general public and the real estate community an opportunity to raise concerns and present testimony. These hearings are often held in various parts of the state to provide everyone a reasonable opportunity to attend. The hearings and proposals are published in a Notice of Proposed Rule Making. If someone cannot attend a hearing, statements can usually be submitted in written form prior to the cutoff deadline.

The Commissioners consider the testimony and other comments presented and make their final determination about the proposed rules. On occasion, the Commission determines it is essential that a rule becomes effective immediately without the delay necessitated by the public hearing process. In those cases, an Emergency Rule can be implemented.

In an effort to provide clarification and guidance to the real estate community when questions arise about particular rules or issues, the Commission may issue a Position Statement. This is a full discussion of a certain rule or point of law the Commission realizes the real estate community has found confusing. Position Statements do not have the force and effect of

a Commission Rule (or a Colorado law), but they provide clear notice to the real estate community regarding how the Commission will interpret the rules and laws should a real estate broker's conduct come into question.

## A BROKER'S RIGHT TO PRACTICE LAW AND COMMISSION RULES

Two landmark real estate cases occurred in 1957 that impacted how real estate brokerage is practiced in Colorado. In the first case, *Conway-Bogue Realty Investment Company v. Denver Bar Association*, brokers were given a limited right to practice law. This includes the right to fill in real estate contracts and explain a contract's meaning to clients.

The Colorado Supreme Court stipulated three requirements for brokers under the *Conway-Bogue* decision:

- The brokerage firm must be connected with the transaction as a broker. This means that brokers may not prepare documents for parties with whom they do not have a relationship to represent called a “brokerage relationship.” They must be acting as either an agent or a transaction-broker for one of the parties to the transaction or they are in violation of this requirement.
- There must be no fee for preparing the documents other than the normal real estate commission. Part of the fee structure of a commission is the preparation of appropriate documents for that transaction; charging additional fees to prepare legal documents, such as deeds and bills of sale, is not acceptable.
- The documents must be prepared on commonly used, printed, standard, or approved forms. A standard form is one created by an attorney to fit general situations. An apartment lease, for example, is often a standard form, purchased at an office supply store or from an internet site. This form can be used by a broker to meet the client needs. Approved forms are those approved by the Colorado Real Estate Commission and fall under the Commission rules promulgated by the Colorado Real Estate Commission to identify which forms are approved for use by Colorado real estate brokers.

The court added a requirement that real estate brokers must recommend the use of attorneys to their clients and customers in real estate transactions. Buyers and sellers are not required to use an attorney, but the real estate broker must make it clear that the broker is not an expert in certain areas and the buyer or seller may wish to consult with a lawyer.

The second landmark case was *Title Guaranty Co. v. Denver Bar Association*. This case determined that title companies, unlike real estate brokers, do not have the right to complete legal documents. A real estate broker must hire the title company as a “scrivener.” The form used to hire the title company is called “Closing Instructions” and is to be completed no later than delivery of the earnest money to the listing brokerage firm.

Two other important points came from this case. First, brokers are not allowed to receive referral fees or other inducements from title companies. In addition, a real estate broker must recommend to the buyer or seller, prior to the closing of a real estate transaction, that an attorney examine the title.

### Commission-Approved Forms

The *Conway-Bogue* decision required that brokers use standard or approved forms when they assist real estate clients and customers. Beginning in 1971, the Colorado Real Estate Commission developed and approved a wide variety of forms to assist brokers in complying with the *Conway-Bogue* decision.

The Use of Standard and Approved Forms describes the forms and requires that brokers use approved forms when one exists for the goal the broker is trying to achieve. Additional requirements of these rules are as follows:

- Brokers may not alter the standard language as approved.
- Brokers may add information identifying the brokerage firm when the forms are printed.
- If any approved provision of a form is deleted or struck out as directed by a party to the contract, it must be crossed out so the deleted words remain legible. For example:

Acceptable: ~~This strikethrough is acceptable.~~

Not acceptable: ~~This strikethrough is not acceptable.~~

- Language added in **blank spaces** must be in *italics* or in different typeface/font than the preprinted language so the reader can tell the difference between the language added to the blanks and the approved language.
- Certain **specific** provisions may be omitted from the approved form when it is printed if those provisions do not apply to a particular transaction. Nevertheless, the caption or heading must be retained and the word “OMITTED” must be added after the caption.

For example, to omit the “Assumption” subsection in the Contract to Buy and Sell, all the financing language could be omitted as long as the heading plus omitted is still printed:

#### 4.6. Assumption. OMITTED

- All approved forms must have the following statement of Commission approval on the first page:

**The printed portions of this form, except differentiated additions, have been approved by the Colorado Real Estate Commission** (insert form number).

The “differentiated additions” (in the above text) are the words the broker fills in the blanks and must be in a **different** type style.

- A broker who is not a party to a contract may not add personal provisions, personal disclaimers, or **exculpatory language** in an addendum. These would, however, be acceptable in an employment agreement where the broker is a principal party. Provisions limiting a broker’s liability are referred to as *exculpatory clauses*.

For example: This means that a broker or brokerage may create and attach an addendum to the Exclusive-Right-to-Sell Listing Contract modifying or adding to the contract. However, the broker who is not a party to the Contract to Buy and Sell (this agreement is between the buyer and the seller) may not add an addendum, especially one that tries to modify or limit the broker’s obligations to the parties.

Commission rules state that if a broker uses a preprinted or prepared addendum that modifies or adds to the terms of a Commission-approved contract form, and the addendum **does not result from negotiations** of the parties, then such addendum must be prepared by one of the following:

- An attorney representing the broker or brokerage firm
- A principal to the transaction
- An attorney representing a principal party

NOTE: Such addenda **may not** be prepared by the broker or brokers for the parties.

**FOR EXAMPLE**

The Contract to Buy and Sell does not address mold disclosure, an important issue in property. Therefore, many firms have had their attorneys prepare a mold disclosure form to be attached the Contract to Buy and Sell. Since the form was not negotiated between the buyer and the seller, an attorney for the firm must prepare this addendum and the names of the law firm and attorney who prepared the form must be part of the agreement.

Any addenda used by a broker to explain or add to the terms of the approved form must be carefully prepared as described in the Commission rules and must contain a disclaimer saying the language of the addendum is not approved by the Colorado Real Estate Commission. The brokerage firm is not allowed to have their attorney prepare contracts for general use in the firm. The brokers would need to use Commission-approved forms.

Computer-generated contract forms: There are a number of computer software programs available to complete and generate the approved Colorado forms. The Commission rules require these software programs to reproduce the Commission language exactly as approved. Additionally, the software program must have a security feature to prevent the user from altering the approved language or deleting part of the form.

The Commission rules state that contract forms may not be filled out prior to **negotiation** with the party. Brokers are obligated to write and present all offers as given to them by the seller or buyer.

The Commission has not approved forms for every possible type of transaction. There are no approved lease forms, and there are no approved forms for the various types of conveyance deeds. Brokers may use standard forms available from office supply stores and legal printing companies for these documents.

The Commission rules do not apply to the following:

- Contracts for new homes with warranties
- Contracts prepared by a subdivision developer

An installment land contract form has not been approved by the Commission; it is recommended that a broker using an installment land contract should have it drafted by an attorney.

Attorneys do not fall under these rules and may prepare contracts for any party in the transaction or, if requested, for the brokerage firm in a specific transaction.

## OTHER COLORADO LEGAL ISSUES

### ***Methamphetamine Labs***

The Colorado legislature has taken steps to ensure buyers receive some protection from unknowingly purchasing houses that have ever been used as methamphetamine (meth) labs. Disclosure requirements have been placed on sellers regarding known previous use of the property as a meth lab. Sellers may be exempt from the disclosure requirement if the property has been remediated (cleaned) according to very precise state standards. Legal guidance in this area is essential if a broker is involved in the listing, sale, or purchase of a property that has had, or may have had, a meth lab.

## Foreclosures

Colorado and other states have experienced many issues surrounding the purchase and sale of properties “in foreclosure” (a property where the owner has defaulted on the mortgage loan and the lender has initiated procedures to sell the property to repay itself the outstanding loan amount). Colorado has enacted laws intended to protect sellers whose property is in foreclosure at the time of the listing and sale. The law requires disclosure of the situation and places very stringent requirements on real estate licensees involved in such situations. This is another area where competent legal advice is essential for the broker to ensure compliance with the law.

## Square Footage Disclosure and Measuring Houses

The proper reporting of the square footage of a house is often a significant issue. Whether square footage is used for the purpose of marketing a house (i.e., included in the MLS listing or in an advertisement) or is of concern to a buyer, accuracy is essential. The Colorado Real Estate Commission has taken the position that the method used to measure square footage is to be consistent with local custom. As long as everyone in that market measures and reports it the same way, that method is deemed sufficient to preserve accuracy of reporting. However, the Commission also requires licensees to use the Square Footage Disclosure form whenever square footage is used for marketing to ensure all the parties have the same understanding as to the methodology and the source of the measurement. This form is discussed further in Colorado Contracts & Regulations.

## Seller’s Property Disclosure

Sellers and the brokers that represent them are required to disclose all material facts about the property being sold. The Colorado Real Estate Commission has an approved form for the seller to use for these disclosures. This form is to be **completed by the seller, not the listing broker**, to the best of the *seller’s current actual knowledge*. The listing broker then gives the form to the buyer and verifies that the buyer received the form. The form is to be delivered either before an offer is written or by the date requested in the Contract to Buy and Sell. This form is used to protect brokers from the seller failing to disclose latent, hidden defects. Brokers are obligated to conduct a visual inspection of the property and to verify that there are no undisclosed visible defects.

# FAIR HOUSING ISSUES

Real estate brokers working with buyers and sellers are subject to fair housing laws. Tricky situations can arise that might lead a well-intentioned broker, new or experienced, into committing a fair housing violation. Fair housing laws are intended to ensure the ability of every consumer to be able to purchase real estate anywhere based solely on the buyer’s financial ability to pay for it. Some violations are clear and easy to identify. Others might not be. Consider the following examples:

- A buyer wants to purchase property in a neighborhood comprised of people of a similar ethnic or religious background and asks the broker to show houses only in such neighborhoods.
- A seller wants to be sure that the “right kind” of people buy the house so the neighbors are “comfortable” with the new owners.

A broker should never suggest neighborhoods to a potential buyer based on where the buyer might go to church, synagogue, or any other religious institution. Even suggesting a neighborhood based on the school district might be a violation. Brokers are well-advised to point interested buyers to sources of information and let the buyers do their own research and form their own opinions.

Housing discrimination can take many forms, but be aware that courts are apt to treat potential complaints very seriously; any leniency shown by the courts will favor the member of the public alleging a violation, not the broker or other alleged wrongdoer.

Seeking assistance and counsel from the employing broker in any situation where a broker associate is unsure, even if something just doesn't "feel right," is a wise course of action.

## REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

RESPA is the federal law that applies to lenders, title companies, and real estate brokers. It requires lenders to make certain disclosures to consumers about residential mortgage loans. The law also prohibits the payment or receipt of kickbacks and certain kinds of referral fees. (Referral fees between brokers are permitted.) Basically, unless a buyer pays the entire purchase price in cash or obtains a loan from the seller of the home (private financing), RESPA will apply because a federally regulated lender will be involved in making the loan.

RESPA is a complex set of laws and regulations. For example, RESPA prohibits title companies from **regularly** providing dinner and receptions to real estate agents, but it does permit a title company representative to buy a broker dinner as long as business is discussed, and as long as such dinners are not a regular occurrence. Sound confusing? RESPA is a source of frustration for some brokers, especially when the broker thinks it interferes with business or marketing practices. No one wants to violate the law, and especially not federal law, which often carries even more severe fines and penalties than state law. However, to avoid such violations, it is necessary to understand the law. Brokers are encouraged to seek education in this important aspect of real estate brokerage. Figure 1.1: RESPA Dos and Don'ts illustrates some RESPA basics that you should become familiar with.



Figure 1.1: RESPA Dos and Don'ts

## RESPA DO's

Real estate brokers and agents must comply with the Real Estate Settlement Procedures Act, or RESPA. Violators of RESPA may receive harsh penalties, including triple damages, fines, and even imprisonment. Here are a few examples of what RESPA allows.


### RESPA...

- ✓ **Allows** a title agent to provide, during an open house, a modest food tray in connection with the title company's marketing information indicating that the refreshments are sponsored by the title company.
- ✓ **Allows** a home inspection company to sponsor association events when representatives from that company also attend and to post a sign identifying its services and sponsorship of the event.
- ✓ **Allows** you to jointly advertise with a mortgage broker if you pay a share of the costs in proportion with your prominence in the advertisement.
- ✓ **Allows** a lender to pay you fair market value to rent a desk, copy machine and phone line in your office to pre-qualify applicants.
- ✓ **Allows** a hazard insurance company to give you marketing materials such as notepads, pens and desk blotters which promote the hazard insurance company's name.
- ✓ **Allows** a title agent to pay for your dinner when business is discussed, provided that such dinners are not a regular occurrence.

**Speak with a RESPA attorney to make sure you comply with all applicable laws. Some state and local laws prohibit activities that are permissible under RESPA.**

**For additional information on RESPA visit:**  
[www.realtor.org/RESPA](http://www.realtor.org/RESPA)

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## RESPA DON'Ts

RESPA prohibits giving or receiving anything for the referral of settlement services, subject to certain exceptions. Violators of RESPA may receive harsh penalties, including triple damages, fines, and even imprisonment. Here are a few examples of what RESPA prohibits.

### RESPA...

- ⊗ **Prohibits** a title company from regularly providing dinner and reception for real estate agents.
- ⊗ **Prohibits** acceptance of discounted or free business equipment, such as a free lock-box.
- ⊗ **Prohibits** acceptance of reimbursement of the cost for an open house lunch from a mortgage broker who doesn't display any marketing materials at the event.
- ⊗ **Prohibits** acceptance of a dinner paid for by a home inspector who doesn't attend the dinner to market his/her services to you.
- ⊗ **Prohibits** acceptance of contributions from a title company to offset the cost of a real estate agent's promotional event except to the extent of the value of any marketing done by the title company during that event.
- ⊗ **Prohibits** accepting gifts from mortgage brokers, such as paying your greens fees.
- ⊗ **Prohibits** a mortgage broker or title company from paying for your tickets to a sporting event.
- ⊗ **Prohibits** participation in a tropical "get away" weekend, the cost of which is underwritten by a title company, during which only two hours is dedicated to marketing by the title company and the remainder is recreation.
- ⊗ **Don't EVER** accept payment from a mortgage lender just for taking a loan application.

**Disclaimer:** The DO's and DON'Ts examples listed here are just that, only examples. They are not all-inclusive and small variations in the facts can lead to different outcomes. They also do not take into consideration any additional regulations that may have been imposed in your state. Consult a lawyer familiar with RESPA for specific advice.

## LECTURE OUTLINE

### I. FUNCTIONS OF THE REAL ESTATE COMMISSION

#### A. Complaints and Investigation

1. The Commission must investigate all \_\_\_\_\_ complaints.
  - a. Once the complaint is verified, the Commission has two options. The Commission can
    - (1) dismiss the complaint, or
    - (2) ask the broker to \_\_\_\_\_.
  - b. Until the response is received, the Commission may not
    - (1) \_\_\_\_\_,
    - (2) start a lawsuit, or
    - (3) seize the brokerage firm's records.
2. Once the response is received, the Commission may
  - a. dismiss the case,
  - b. issue the lowest form of discipline (a formal warning) called a \_\_\_\_\_, or
  - c. send to a hearing with an administrative law judge.
3. After the hearing and the judge's verdict, the matter is referred back to the Commission. The Commission has the following options:
  - a. Public \_\_\_\_\_ of the broker
  - b. Suspend the broker's license
  - c. Revoke the broker's license
  - d. Fine the broker up to \$2,500 per incident

NOTE: The Commission does not have the right to file criminal charges or assess damages. The Commission may, however, refer the case to the proper criminal authority.

4. Records of all brokers are maintained on the Commission website.

#### B. Audits

1. The Real Estate Commission can audit a brokerage firm at any time.
2. As a standard of practice, the Commission audits brokerage firms on a regular, random basis.
3. The Commission is available to assist all brokers with questions, and the broker can remain anonymous, if preferred.



## II. CONWAY-BOGUE AND COMMISSION RULES

1. *Conway-Bogue* and the Commission rules require brokers to use standard or \_\_\_\_\_ in the practice of real estate.
2. The Colorado Real Estate Commission has approved a wide variety of forms to \_\_\_\_\_ in complying with *Conway-Bogue*.
3. The Commission rules require that \_\_\_\_\_ when applicable.
4. Commission rules keep brokers in \_\_\_\_\_ with the *Conway-Bogue* decision.
5. Permitted and Prohibited Modifications and Form Reproduction of Commission-Approved Forms state the following:

- a. Brokers may not alter the standard language as approved.

- (1) Brokers may add information identifying the brokerage firm name.
- (2) If any approved provision of a form is deleted or struck out as directed by a party to the contract, it must be crossed out so the deleted words remain legible. For example:

Acceptable: ~~This strikethrough is acceptable~~

Not acceptable: ~~This strikethrough is not acceptable~~

- (3) Language added in blank spaces must be in *italics* or in different typeface or font than the preprinted language so the reader can tell the difference between the language added to the blanks and the approved language.
- b. Certain **specific** provisions may be omitted from the approved form when it is printed if those provisions do not apply to a particular transaction. Nevertheless, the caption or heading must be retained and the words “OMITTED—NOT APPLICABLE” must be added after the caption.
- (1) For example, to omit the “Assumption” subsection:

### 4.6. Assumption. OMITTED—NOT APPLICABLE

- c. Approved forms must have a statement of Commission approval on the first page:

The printed portions of this form, except differentiated additions, have been approved by the Colorado Real Estate Commission (insert form number). (Mandatory date).

6. Commission rules require that the “additional provisions” section of any form includes only transaction-specific agreements \_\_\_\_\_ **between the parties** and be labeled as follows:  
  
“The following additional provisions have not been approved by the Colorado Real Estate Commission.”
7. A broker who is not a party to a contract \_\_\_\_\_ add personal provisions, personal disclaimers, or *exculpatory language* in an addendum. These would, however, be acceptable in an employment agreement where the broker is a principal party.
  - a. Provisions limiting a broker’s liability are sometimes referred to as *exculpatory clauses*.

8. Any addenda used by a broker to explain or add to the terms of the approved form must be carefully prepared as described in the CREM and must contain a disclaimer that the language of the addendum is not approved by the Colorado Real Estate Commission.
  - a. **The CREM addenda:** If a broker uses a preprinted or prepared addendum that modifies or adds to the terms of a Commission-approved contract form, and the addendum does not result from the \_\_\_\_\_ of the parties, then such addendum must be prepared by
    - (1) an attorney representing the broker or brokerage firm,
    - (2) a principal to the transaction, or
    - (3) an attorney representing a principal party.

NOTE: Such addenda may not be prepared by \_\_\_\_\_ for the parties.

    - (4) Broker must retain the addendum for four years from the last date the addendum was used.
    - (5) Broker must be able to provide the Commission with the name of the attorney or law firm that prepared the addendum upon request.
9. Computer-generated contract forms
  - a. Computer software programs are available to complete and generate the approved forms.
  - b. These software programs must reproduce the Commission language \_\_\_\_\_ as approved.
  - c. The software program must have a security feature to prevent the user from altering the approved language or deleting part of the form.
10. The Commission has approved forms for several types of conveyance deeds. (There are no approved forms for bargain and sale deeds, personal representative deeds, etc.)
  - a. Brokers may use standard forms available from office supply stores and printing companies for leases and other forms.
11. Contract forms may not be filled out \_\_\_\_\_ with the party.
12. Commission rules do not apply to the following:
  - a. Contracts for \_\_\_\_\_
  - b. Contracts prepared by a subdivision developer
  - c. An installment land contract form has not been approved by the Commission. It is recommended that a broker using an installment land contract should have it drafted by an attorney.
13. Attorneys do not fall under these rules and may prepare contracts for any party in the transaction or, if requested, for the brokerage firm in a \_\_\_\_\_.
  - a. A brokerage firm is NOT allowed to have its attorney prepare contracts for \_\_\_\_\_. The brokers would need to use Commission-approved forms.

### III. OTHER CURRENT LEGAL ISSUES

1. Methamphetamine laboratory (meth lab)
  - a. Sellers must disclose if the property has been used as a meth lab.
    - (1) If the property is cleaned and certified per state regulations, the seller \_\_\_\_\_.
  - b. The buyer has the right to have the property tested; if it tests positive, the buyer may terminate the contract.
2. Measuring properties
  - a. If a listing broker uses square footage in the marketing of a residential property, the broker must
    - (1) use the approved Square Footage Disclosure;
    - (2) \_\_\_\_\_ to measure the property; or
    - (3) \_\_\_\_\_ of the measurement, such as an appraisal.
3. Seller's Property Disclosure
  - a. The seller is expected to use the form to list all adverse material facts about the property.
  - b. The form is filled out to the best of the \_\_\_\_\_.
  - c. The \_\_\_\_\_ to confirm receipt of the form.
  - d. Brokers \_\_\_\_\_.

### IV. FAIR HOUSING

1. Federal Fair Housing protected classes:

F \_\_\_\_\_

R \_\_\_\_\_

e equal

S \_\_\_\_\_

H \_\_\_\_\_

C \_\_\_\_\_

o opportunity

R \_\_\_\_\_

N \_\_\_\_\_

Colorado adds these:

M \_\_\_\_\_

S \_\_\_\_\_

2. A broker suggesting that someone live by a certain church or school, or in a certain area, would be guilty of \_\_\_\_\_.
3. Declining to give a buyer a loan because of high crime rates in a neighborhood is an example of \_\_\_\_\_.
4. A broker suggesting that values will go down because a different ethnic group has moved in may be guilty of \_\_\_\_\_.

**V. RESPA (REAL ESTATE SETTLEMENT PROCEDURES ACT)**

1. Governs any residential transaction involving a federally-regulated loan
2. Covers relationships, if any, between the brokers, lenders, title companies, and other entities involved in real estate transactions
3. Prevents kickbacks between these entities
4. Referral fees between brokers is okay
5. Know the basic DOs and DON'Ts

## CASE STUDIES

These case studies are taken from actual cases investigated by the Real Estate Commission. They represent the types of situations a broker can encounter. They can be instructive for new licensees to review and consider what might have gone wrong and what should have been done to avoid the problem in the first place.

For the exercises, you may be acting in the role of a member of the Real Estate Commission. You will review the facts of the situation as presented and consider whether or not a violation of rules or law has occurred. If you find a referral to a hearing is appropriate (i.e., violations have occurred), then you are to develop guidelines for a settlement proposal you think would equitably resolve the matter (an expedited settlement). The respondent-broker will not be present during your deliberations, so you may only consider the facts presented in the case scenario.

In developing the expedited settlement, you should consider the nature of the complaint and the various disciplinary options available to you. If appropriate, restitution should be included in the settlement offer. If criminal behavior is evident, you should also discuss referral to the district attorney.

These complaints can come from the public, other real estate brokers, or the Commission staff.

## CASE #1

Purchasers entered into a purchase contract on a rural property. The contract contained a contingency: “Seller to provide all pertinent information regarding the well and septic to include results from testing all the systems.”

The listing broker had managed the property as a rental and was aware that the well produced water at a very low rate (six gallons per hour). He claimed that he made the buyers’ broker aware of that fact. The buyers’ broker denied being given such disclosure. The brokers also disagreed on the transfer and receipt of a previous well test; however, neither had a signature showing the buyer had received the disclosure.

In the Seller’s Property Disclosure form, the seller stated that the well was working; however, the seller lived out of state and had not seen the property for a year. The purchasers were not made aware of the information regarding the flow rate and were not given the results of the old well test. As of the day of closing, the purchasers had not received any information relating to the contingency.

The buyers’ broker claims he informed the purchasers that they could delay the closing. The purchasers did not recall being given that advice and stated that they closed because the listing broker assured them there was no problem with the well.

Approximately two weeks after closing, the purchasers were completely out of water and sought assistance from the real estate brokers.

The purchasers contacted the Real Estate Commission when they became dissatisfied with the response from the brokers.

### What do you think?

- Has there been a violation of real estate license law or Commission rules?
- What procedures could have been used to address the issue of “bad memories” on the part of the buyers and the brokers?
- Do you have any suggestions regarding the wording of the contingency?
- In your opinion, what should happen to the brokers?

## CASE #2

Second-year CSU college student Ryan and his parents decided to purchase a condominium near the campus for Ryan to live in, rather than the dorms. Ryan has a medium-sized dog that is considered a member of the family. Through a classmate, Ryan met a broker, Jeff, who had been licensed for four months. Ryan told Jeff the most important consideration in finding a property is that the dog be allowed. The parties entered into an Exclusive Right-to-Buy Listing Contract with Jeff representing Ryan as an agent.

Ryan quickly found a unit in the Westside Condominiums that interested him. The MLS printout for the unit indicated that dogs and cats were allowed. While previewing the unit, Jeff and Ryan noticed another unit for sale. They looked at the second unit and decided to make an offer on it instead. The MLS printout for the second unit did not address pets.

Ryan wanted his friend to see the unit, so they went by a few days later. Ryan and his friend noticed “No Dogs Allowed” signs in various places around the complex. Ryan asked Jeff about the signs. Jeff replied that residents’ dogs were allowed on the property but that nonresidents’ dogs were not. After closing, Ryan received notice from the Westside Owners Association that having a dog violated the Association’s covenants. This was the first time Ryan and his parents were provided with the governing documents for the community.

### Broker’s Response

Broker Jeff stated that he was provided with a copy of the covenants when he received the title commitment. Jeff put the covenants in his work file and admits to not providing a copy to Ryan. He believed it was the responsibility of the seller or the title company to provide the documents to Ryan. The contract did call for the seller to provide the governing documents, but Jeff’s statutory obligations as a buyer’s agent require that he exercise skill and care, which means assuring that the buyer’s interests are safeguarded.

The title company could not confirm mailing a copy of the covenants to Ryan or his parents. The employing broker admitted to not telling Jeff that he needed to provide Ryan with a copy of the covenants, and the employing broker further stated that he advises his agents not to review title work or HOA documents because his agents are not experts.

### What do you think?

- Has there been a violation of real estate license law or Commission rules?
- What procedures led to the problem?
- What should have been done differently by the buyer’s broker?

- Do employing brokers have a responsibility to review title work?

### CASE #3

Broker Sarah managed several homeowners associations and one commercial shopping center for a number of years. A Real Estate Commission examination began after clients discovered that the broker had left town without notice. The audit covered a period of two years and discovered a shortage totaling \$54,000 in various accounts.

Although monthly reports were made to the associations, Sarah withdrew various amounts of funds from the escrow accounts for personal and business use. She was able to conceal these activities because of the lack of any independent audit. The records were not reviewed in detail by the associations concerned, and some association board members and a property owner were long-time friends of Sarah. Several large checks were written to legitimate parties according to check stub entries, but were in fact cashed by Sarah.

Amounts entered in the monthly reports were misstated to create secret cash reserves in the account for the broker's personal use. Beginning and ending check numbers shown in the annual association reports were out of sequence, and voided checks were used to manipulate the account balances and bank reconciliations.

Stub balances were misstated to agree with forced bank reconciliations, and amounts actually paid to vendors frequently differed from those reported. Some cash receipts were never deposited to the escrow accounts.

#### What do you think?

- Has there been a violation of real estate license law or Commission rules?
- Is it appropriate for a broker to mix personal and trust funds?
- What might the associations have done to have avoided this problem?

## CASE #4

Broker Mary listed a residential property for her sister and brother-in-law as a sellers' agent. At the time of the listing, the sellers completed a Seller's Property Disclosure (SPD) form that indicated the property had settling, sliding, and expansive soil. After nearly a year, the property had not sold and Mary decided to buy it from her clients as an investment property.

Broker Mary told a close friend, Broker Paul, that the property had structural problems. Paul visited the property and noticed that the living room floor was uneven. Paul referred Mary to a contractor friend to repair the property. The contractor performed repairs on the living room floor and other areas of the home at a cost of \$25,000.

Some months later, Paul executed an Exclusive Right-to-Sell Listing Contract with Mary as seller. Paul completed a Seller's Property Disclosure form by lining through each page, and on page one, he indicated that the seller had never lived in the property. Within a few days, the property was under contract and closing occurred.

Six months later, the property has cracks in the walls, and windowsills were breaking away from the walls. The new owners hired a structural engineer to inspect the property. The engineer's report stated that, due to structural distress, the property was no longer habitable. The buyers filed a complaint with the Colorado Real Estate Commission for alleged failure to disclose a known material defect. Both Mary and Paul were named in the complaint.

### Broker's Response

Paul believes the way he completed the Seller's Property Disclosure was proper, as he wanted the buyers to know that the seller had never lived in the property. Furthermore, Paul states that, to the best of his knowledge, there were no disclosures because, according to Mary, all of the repairs had been completed. Mary states that Paul told her she did not have to disclose the structural problems since they had been repaired. It is learned that the repairman is not a licensed contractor and had little experience with structural repairs. According to Mary, due to the death of her two dogs, she was emotionally distressed and did not pay attention to what was going on at the property during the time the repairs were done.

### What do you think?

- Has there been a violation of real estate license law or Commission rules?
  
  
  
  
  
  
  
  
  
  
- Was Mary protected from Real Estate Commission oversight by listing the property with another broker? Was Paul's conduct appropriate?
  
  
  
  
  
  
  
  
  
  
- Do you have suggestions for how the brokers might have better handled this situation?





# Colorado Contracts and Regulations

- Unit 1:** Real Estate Brokerage in Colorado
- Unit 2:** The Seller and Buyer Relationship
- Unit 3:** Colorado Contract to Buy and Sell Real Estate
- Unit 4:** Colorado Contract to Buy and Sell Real Estate, continued
- Unit 5:** Additional Transaction Documents and Regulations
- Unit 6:** Fair Housing, Property Management, Leasing, and the Law



# UNIT 1

## Real Estate Brokerage in Colorado

### **COLORADO REAL ESTATE LICENSING AND LEVELS OF AUTHORITY**

Colorado real estate brokers work under the jurisdiction of the Colorado Real Estate Commission and the real estate license law approved by the state legislature. The license law establishes the way business is done and provides real estate services to sellers, buyers, landlords, and tenants. The Real Estate Commission assists brokers in following the law through specific rules, position statements, and approved forms. The Commission recognizes three levels of responsibility for brokers based on experience and additional education: (1) associate brokers, (2) independent brokers, and (3) employing brokers.

An associate broker is either a new broker with less than two years of active experience or a broker who (regardless of experience) is working under an employing broker. An associate broker with less than two years' active experience must work under the supervision of an employing broker until the necessary experience is gained. During this period, the employing broker is responsible for maintaining a high level of supervision of the less-experienced broker. This level of supervision would include specific training on company policies, assistance with closings, including attending closings or assigning other qualified brokers to attend closings, and being available to answer questions. During this period, the employing broker should aim to make sure the broker is gaining the competency necessary to work with less supervision in the future. After completing the experience requirement, the associate broker will qualify as an independent broker and may change to this license status without any further testing or education. The associate broker could also, with further education, apply to be an employing broker. No matter what level of license brokers have, they will be called associate brokers any time their license is placed under an employing broker's license.

An independent broker must have a minimum of two years of active experience and may work independently and be licensed as an individual or a business entity. An independent broker may not hire or supervise other licensees which would include hiring a licensed assistant. An independent broker must have an employing broker license to hire an actively licensed assistant.

Employing brokers must have a minimum of two years of active experience and must complete an additional 24-hour course in brokerage administration to be qualified to hire and supervise other licensees. Employing brokers must provide a reasonable level of supervision to employed brokers with two or more years of active experience. A reasonable level of supervision includes providing a company policy manual and assuring that all licensees, no matter their experience level, read it and sign that they have read it and agree to uphold the office policies. Employing brokers are also responsible for reviewing all contracts prepared by every broker to ensure the contracts are correctly prepared. Employing brokers are accountable for all licensees whose licenses are held under them.

## COLORADO BROKERAGE RELATIONSHIPS

Colorado real estate brokerage relationship laws are based on the common laws of agency and state statutes that define the relationships that brokers are allowed to have with consumers in real estate transactions. Colorado law allows for two types of representation: agency and transaction brokerage. However, there is a third relationship in which the consumer is an unrepresented customer: the dual or subagency relationship. Colorado does not allow this type of relationship.

An active real estate licensee's job title is that of a real estate broker, not a real estate agent. A real estate agent is hired to represent a principal while a real estate broker has numerous jobs, including finding buyers and sellers to represent. Licensees begin work each day as real estate brokers who may or may not have a number of representation roles depending on how productive their business is. It is helpful to differentiate these two roles when learning about the laws of agency. Licensed real estate professionals always have the duties of a real estate broker but are not agents unless hired to represent a principal.

Brokers are hired to protect the interests, property, and money of principals, and they agree to fulfill basic fiduciary (trust) duties in addition to those that may be created through a contract. Most agent's or transaction-broker's duties are the same under Colorado representation contracts. A broker acting as an agent is an advocate and has three additional job duties tied to obedience and loyalty.

### Overview of Agency Law

Typical agency relationships exist between principals and attorneys, doctors, insurance and real estate agents, and stockbrokers. The fiduciary duties learned under the common law of agency of obedience, loyalty, disclosure, confidentiality, accounting, and reasonable skill and care (OLD CAR) apply to these relationships, along with any additional obligations created by the contract between the parties.

Agents agree to represent the interests of a principal by putting the principal's interest above their own. The principal gives the agent permission to act and advocate on the principal's behalf. The agent's actions, particularly in relation to third parties, may bind the principal. A listing broker who tells a buyer that "the seller will paint the living room" may have obligated the seller to paint the living room even if the seller/principal did not tell the agent she was willing to do so. The seller may become vicariously liable for the agent's actions. Of course, the seller could seek recourse, such as insisting that the listing broker pay for the paint. The important issue is that real estate brokers must be careful not to make promises or statements that have not been expressed by the principal.

Agency may be created by express agreement, oral or written, or by implication. Implied agency is created by action, such as when a broker acts as an agent without anything in

writing and is considered an agent by implication. Of particular concern is undisclosed agency, especially if the agent becomes an undisclosed dual agent.

**FOR EXAMPLE**

Linda, the listing agent, received a call from a buyer interested in the property. Linda failed to disclose her agency relationship with the seller and told the buyer that “the seller is very motivated and will take \$10,000 less than the current asking price.” By sharing the seller’s confidential information, which helps the buyer, Linda has become an undisclosed dual agent with a buyer agency relationship created by implication.

The agent’s obligations are spelled out in the representation contract and typically create a special agency relationship between the brokerage firm and the principal. In special agency, agents work with principals to sell or purchase property, and they do not have the power to bind the seller or the buyer by accepting a purchase contract for the party they represent. If the firm or broker is representing a principal as a property manager, the property management contract typically establishes a general agency relationship in which the agent has limited power to bind the principal. This authority is created within the contract and would allow the property manager to spend the principal’s money up to an amount agreed to by the parties. In rare cases, brokers might be given full power to bind a principal as though the principal were acting in his own interest; this is known as universal agency. Universal agency is created with a document called a power of attorney (POA) and makes the agent an attorney-in-fact. The power of attorney can be unlimited and give the agent full power over all the principal’s interests, or it can be limited (more typical in real estate) and give the agent power to perform only specific acts for the principal, such as attending the closing and signing the closing paperwork if the principal is unable to attend.

In Colorado, an agent may only act as a single agent representing one party in the transaction. This is the most typical relationship. The seller is represented by a listing single agent and the buyer is represented by a buyer’s single agent. A broker who intends to work both sides of the transaction may not do so as an agent.

Colorado law also allows brokers to offer nonagent representation, called transaction brokerage. The broker still has representation obligations to the buyer or the seller but does not have the full fiduciary obligations of an agent. Typically, a transaction-broker is required to disclose all material facts, maintain confidentiality about price, terms, and motivations, account for all funds, and uses reasonable skill and care (DCAR). Because transaction-brokers have fewer obligations to consumers, they may work with both parties in a transaction. Transaction-brokers do not have the obligations of loyalty and obedience but still must maintain the confidentiality of each party, especially when working with both parties.

Colorado brokers can also work with consumers who do not have brokerage representation. In this case, the consumer is known as a customer. This occurs when the broker is representing another party as an agent without the option to move to transaction brokerage. Brokers owe customers disclosure of material facts, accounting, and honesty. Note that confidentiality is not an obligation in this situation, and if given or learning confidential information about the customer, the broker would be obligated to share this information with the party the broker represents.

Remember: Agents’ obligations are OLD CAR, transaction-brokers owe DCAR, and customers are given DAH.

**Brokerage Relationship Disclosure**

All states require that brokers, especially those acting as agents, disclose their agency or representation obligations no later than at the first substantive contact, which is typically

the first physical contact. In all cases, brokers must disclose agency representation before receiving confidential information from the consumer who is not represented. Under the fiduciary duty of disclosure, an agent is obligated to disclose to the principal anything about the other party that might benefit the agent's principal. In particular, if the agent learned information about the other party's willingness to pay more, terms they were willing to give, or motivations to move forward, the agent would be obligated to share this information with the principal.

Because most consumers do not understand the laws or obligations of agency, the law requires real estate professionals to disclose any agency relationships before the consumer is at a disadvantage in a subsequent transaction. Most states, including Colorado, have a written disclosure form that the broker is required to give to the consumer. Typically, brokers may have rapport-building, nonspecific conversations without triggering the need to give the agency disclosure. When the conversation begins to lead to more specific points, especially when they are of a personal nature and the consumer appears to be interested in moving forward, the broker is obligated to stop the conversation and review the brokerage relationships available to the consumer. These options may include single agency, transaction-brokerage, or no representation for the consumer.

In most cases, the consumer is asked to sign a copy of the disclosure form for the brokerage file and is given a copy with the broker's signature to show that the form was reviewed and received by the consumer. However, the consumer cannot be forced to sign the disclosure. In this situation, a broker should note the refusal on the brokerage file copy to prove that the requirement was met, sign it, then give the consumer a copy. The requirement to disclose the brokerage relationship has now been met, and the broker should have a clear idea of what type of relationship she has with the consumer.

For example, after reviewing the disclosure, the consumer/buyer could agree to work with the firm if the broker acts as an exclusive buyer's agent. The broker would have the buyer sign a buyer representation contract, which clearly defines the duties and obligations of the parties. (This form will be reviewed later.)

## **Applying Colorado Brokerage Relationship Law**

In Colorado, an agent's duties are the same fiduciary duties as an agent under the common law of agency (OLD CAR). By law, agency relationships also require a written contract signed between the brokerage firm, the broker, and the principal. The two most common contracts are the Exclusive Right-to-Sell Listing Contract and Exclusive Right-to-Buy Listing Contract.

Under Colorado law, a broker acting as an agent may only be a single agent in a single transaction, representing only one side. Licensees may not act as dual agents; they may not represent both parties as an agent in a single transaction. An agent is an advocate promoting the interests of one party over the other. An easy way to think of this role is that the agent acts like a coach working and advocating for only one side of the transaction.

Under Colorado law, a transaction-broker is not an agent for either party. A transaction-broker acts like a referee. The transaction-broker does not promote one side over the other but simply passes information, and each side makes its own decisions. The transaction-broker manages and is obligated to follow the directives of the party or parties the transaction-broker represents.

Transaction-broker is the default relationship in Colorado; it does not require a written contract, only a written disclosure of responsibilities. Transaction-brokers are required to confirm the representation responsibilities that they owe to the member of the public. This confirmation is

done with either an exclusive contract or a disclosure form. The disclosure is completed using one of the five disclosure forms (listed below), but most typically with the Brokerage Disclosure to Buyer or Brokerage Disclosure to Seller (Sale by Owner). However, without a written contract, the member of the public is under no obligation to pay the broker, so most brokers will complete a representation. The two most common written representation contracts are the Exclusive Right-to-Sell Listing Contract and Exclusive Right-to-Buy Listing Contract.

The broker could start the relationship representing one party as a transaction-broker (e.g., a seller's transaction-broker with an Exclusive Right-to-Sell Listing Contract), or the broker could use this same contract and be the seller's agent with or without the right to become a transaction-broker if working with a buyer for the property (double end). Transaction-brokers can work with both sides without a conflict of interest because transaction-brokers do not have the obligations of loyalty, obedience, and advocacy. Transaction-brokers owe DCAR (disclosure, confidentiality, accounting, and reasonable skill and care) to the parties they represent. Remember, a transaction-broker simply acts as a referee, keeping both parties informed but not advocating for either.

A broker who is unable to be neutral cannot be a transaction-broker. For example, a broker typically could not be a transaction-broker when acting as the principal, the broker for a spouse or family member, the broker for a close personal friend or business associate, or the broker for repeat clients or multiple properties for the same client. In these situations, the broker would have to be an agent and, if double-ending the transaction, make the other party a customer.

### Figure 1.1: Transaction-Broker vs. Agent

**While a broker is showing a house, the potential buyer asks, “Do you think a \$250,000 price is the best we can do?”**

#### **A transaction-broker might say:**

“The sellers priced it at \$250,000 after consulting with their broker. I can provide you with information about homes recently sold in this area if you would like.”

#### **An agent might say:**

“Before we toured the house, I ran a CMA and gathered information about recent sales in the neighborhood. As you can see, no home has sold for over \$240,000 this year. If you would like to submit an offer, I would recommend something around \$237,000 to \$239,000. With the current sluggish market, I believe the sellers may be willing to sell for less, and the risk of another buyer offering more is minimal. How would you like me to proceed?”

Colorado law defines a customer in a transaction as “a party to the real estate transaction with whom the broker has no brokerage relationship or no representation, because such party has not engaged or employed any broker.” The broker remains a single agent for the party with whom the broker has an agency contract and may do anything for a customer that does not compromise the agency contract with the principal. The duties that licensees owe to a customer are disclosure, accounting, and honesty (DAH). Note that confidentiality is not owed to the customer but to the principal the agent represents. Brokers must make sure they fully disclose to the consumer/customer that any confidential information received by the agent must be shared with the agent's principal.

For example, a broker would ask a potential buyer to be a customer when the broker's contract with the seller requires the broker to remain an agent (e.g., a listing broker representing her child as a listing agent). Remember, agents in Colorado are single agents—never dual agents.

The reverse situation could occur if the broker was an agent for the buyer and the buyer wanted to buy from an unrepresented seller (for sale by owner [FSBO]). The broker would need to use the Brokerage Disclosure to Seller (Sale by Owner) form.

## **Explaining This to the Public**

Typically, brokers don't want to start each appointment with a one-hour lecture on brokerage relationships. Fortunately, the Real Estate Commission has provided a set of simplified definitions in five disclosure forms: Definitions of Working Relationships, Brokerage Disclosure to Buyer, Brokerage Disclosure to Seller (Sale by Owner), Brokerage Disclosure to Buyer – Tenant, and Brokerage Duties Disclosure to Seller (REO & Non-CREC Approved Listing Contracts). Brokers should be familiar with all the forms and use them when appropriate.

These forms are used to inform the public of the choices for representation and to give proper disclosure as required by law. A broker who has a written, signed exclusive representation contract to act as an agent or transaction-broker does not need these forms unless the employing broker requires them.

### ***Definitions of Working Relationships Disclosure Form***

The Definitions of Working Relationships disclosure form is used as a primary tool to educate the public about the brokerage relationships available under Colorado law. The form is not required for most transactions but provides a good introduction to the available relationships. It reviews the two brokerage relationships in which a broker may represent a member of the public, which are agency and transaction-brokerage. The form also describes the customer relationship.

The types of relationships a broker associate can offer to a consumer are first determined by the written office policy of the associate's brokerage firm. The broker associate may then negotiate with the consumer to establish the working relationship.

For example, the brokerage firm could choose to offer only transaction-brokerage relationships. This means that no broker in that firm can act as an agent for a member of the public. However, brokerage firms typically offer all types of relationships and allow broker associates to offer both agency and transaction brokerage and, if appropriate, make the consumer a customer.

### ***Brokerage Disclosure to Buyer Form***

Like the Definitions of Working Relationships form, the Brokerage Disclosure to Buyer form, provides the Real Estate Commission definitions of the various relationships a broker can have with a seller or buyer. The broker and the buyer can use the form to create a transaction-broker relationship or make the buyer a customer. Additionally, this form is used to bring the broker into compliance with Commission rules, which require brokerage relationship disclosure.

In transaction-brokerage relationships with buyers, brokers should be aware that if they don't have a signed contract, the buyer has no obligation to pay a commission or to use the broker exclusively. Buyers should be informed that they can accept the disclosed relationship or seek an exclusive relationship with the licensee or another broker.

This form is also used to make the buyer a customer when the broker is an agent to the seller and wants to double-end the transaction. Remember, receiving a fee from someone does not establish agency or any other relationship. A written contract, disclosure, or, at times, the broker's actions determine the brokerage relationship.



If the broker has a representation relationship with the seller, the terms of the listing with the seller will dictate the options the broker may offer the buyer (transaction brokerage or the buyer as a customer). Per the Commission rules, this disclosure is mandatory when the broker has an existing relationship with a seller. The broker must disclose the relationship (agency or transaction-broker) to any unrepresented buyer who inquires about the seller's property.

The second page of the disclosure form is used to create a transaction-broker relationship or make the buyer a customer. The form makes it clear that the relationship the broker is disclosing is only for a particular property showing or property type the buyer has asked to see. The three options on the form are the following:

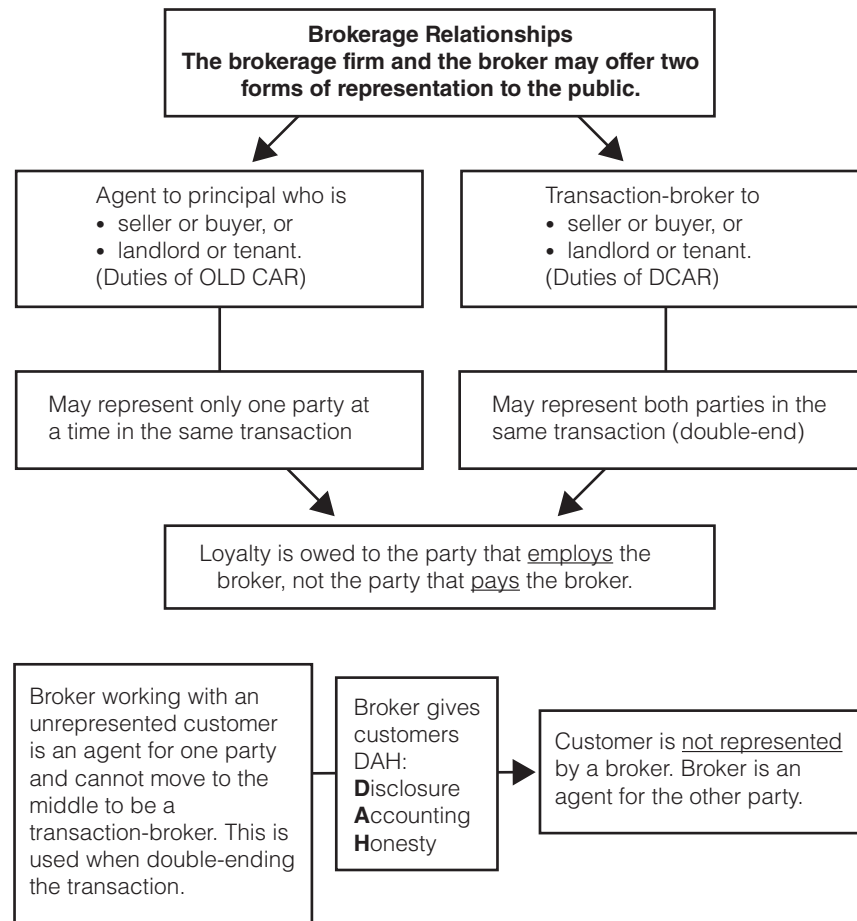
- **Customer:** Check this box if the buyer will always be a customer. The broker plans to show an agency listing(s) to the buyer, and the seller has requested in the listing that the broker remain the seller's agent for showings. The broker will not have a contract to receive a fee from this buyer. The broker may assist the customer in any way that does not compromise the agency relationship with the seller.
- **Customer for Broker's Listings – Transaction-Brokerage for Other Properties:** Check this box when the buyer may be a customer or the broker may represent the buyer as a transaction-broker, depending on the property being shown to the buyer. The broker will be a seller's agent for that broker's listings and a transaction-broker for all other properties.
- **Transaction-Brokerage Only:** Check this box when the broker will be a transaction-broker for all showings of any property, whether or not it is one of the broker's listings. It would create the default representation role without a signed exclusive contract. Sellers of properties the broker has listed must allow, in the written listing contract, a change of status from seller's agent to seller's transaction-broker, thus allowing the broker to work with both the buyer and the seller as a transaction-broker should the opportunity arise.

## Choices for Double-Ending a Transaction Review

Colorado agency contracts provide the broker and the principal two options they may negotiate if the broker gets the opportunity to double-end the transaction. This occurs when the broker is working with both the buyer and the seller in the same transaction. The first choice is for the broker to remain an agent for either the buyer or the seller (stay a single agent) and treat the other party as a customer to double-end the transaction.

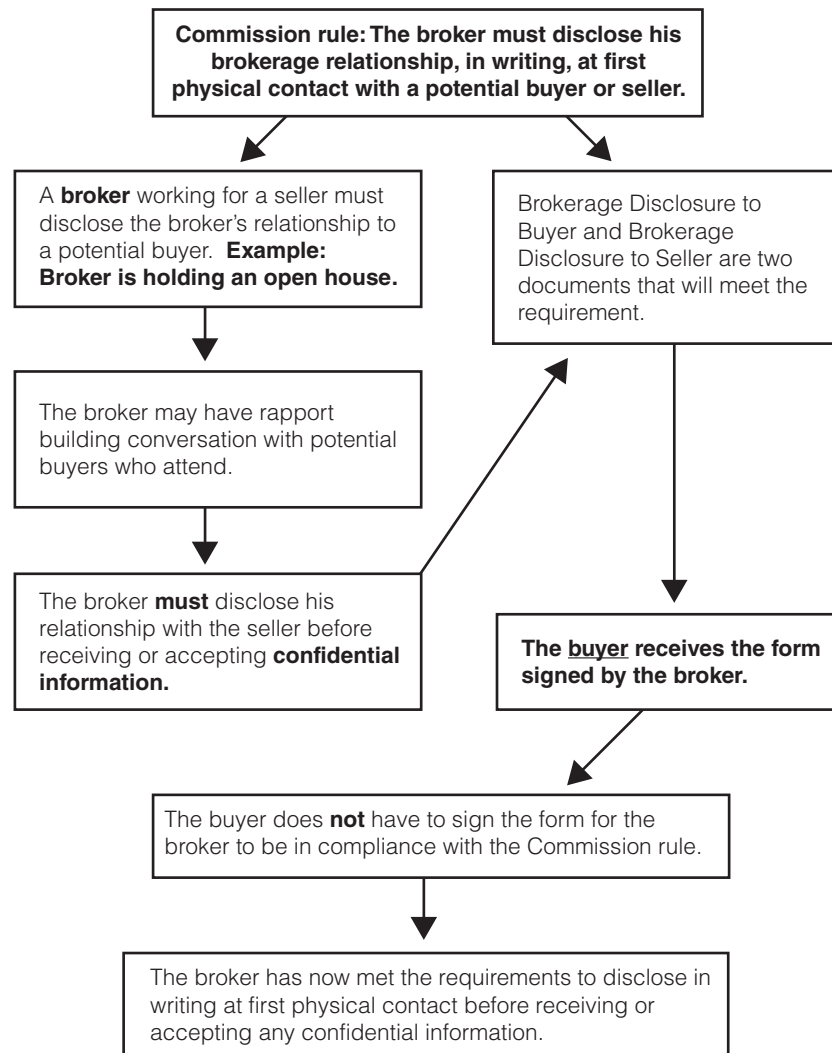
The second option is, with permission from the principal or principals (if working as an agent for both seller and buyer), to automatically change to a transaction-broker to work both sides of the transaction. The permission for this change is given in the listing contract. The law requires that a broker who has a brokerage relationship with both sides must treat both parties equally and cannot be an agent to one party and a transaction-broker to the other. The broker must change status to a transaction-broker when working with both sides.

Instead of double-ending the transaction, the broker could resign one relationship, treat that party as a customer, and keep the other agency relationship.

**Figure 1.2: Brokerage Relationships**

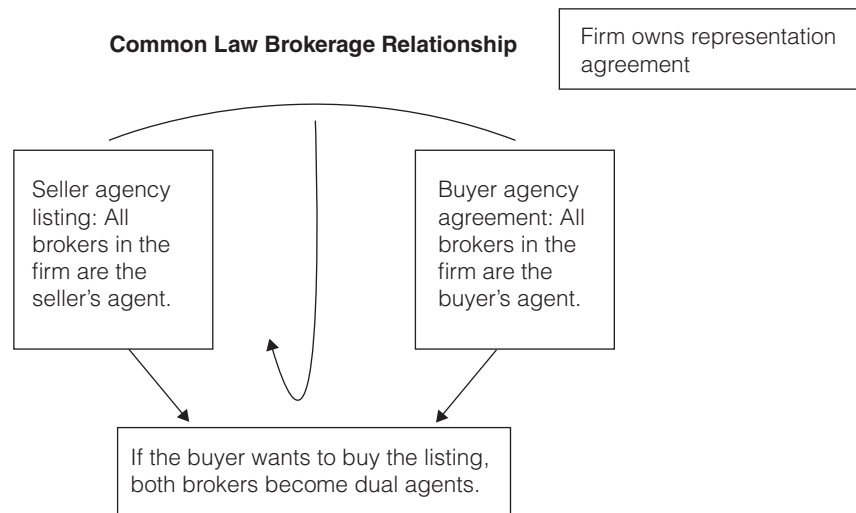
## Disclosure of Brokerage Relationships

The law requires that brokers disclose in writing the relationships they may provide to the public: representation (agent or transaction-broker) or nonrepresentation (the consumer is a customer). Brokers must also disclose any existing relationship they have with one party to a transaction to the other party before discussing potential confidential information, such as motivations or financial qualifications. Don't confuse *in writing* with *signed*; the Commission rules say that the broker must give a written disclosure, not that the consumer has to sign it.

**Figure 1.3: Disclosure of Brokerage Relationships**

## DESIGNATED BROKERAGE

Under common law, once the brokerage firm has obtained an agency listing or buyer representation contract, all of the brokers in the firm are considered part of the contract and are agents of the seller or the buyer. Because the firm and all of its brokers are under one umbrella, they owe the same fiduciary obligations to the seller and the buyer as the brokerage and the broker who signed the contract. In these firms, if a broker brings a buyer to a company listing, the brokers and the firm become dual agents representing both the seller and the buyer.

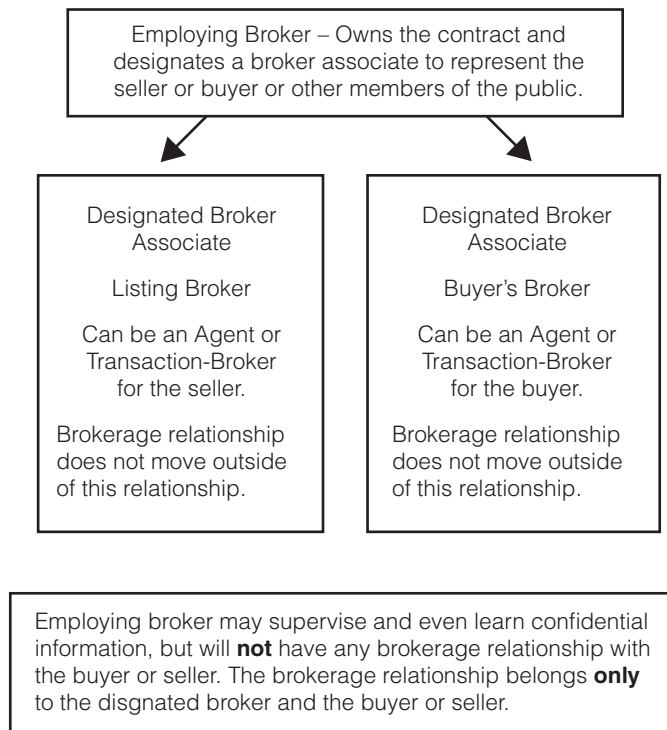
**Figure 1.4: Designated Brokerage**

Colorado removes the umbrella of brokerage relationships for the firm by allowing the employing broker to designate a broker to have an exclusive relationship with a buyer or a seller. This means that the brokerage firm, acting through the firm's brokers, agrees to provide a set of services to a seller, buyer, landlord, or tenant. The brokerage firm owns the listing contract and elects to provide services by designating a broker. The employing broker of the firm designates an individual broker (or a team) within the firm to enter into the brokerage relationship and represent a particular seller or buyer (or landlord or tenant). In designated brokerage, the brokerage relationship stops with the designated broker and does not extend to the rest of the brokerage firm or the employing broker. The agency or transaction-broker relationship (brokerage relationship) and its duties exist only between the seller or the buyer and the designated broker.

The broker designation must be in writing, which is typically done in the brokerage firm's office policy. If necessary, the brokerage firm can replace a designated broker or add an additional designated broker.

Colorado designated-broker provisions allow a designated broker to seek advice from an employing broker and share information about a client with the employing broker without compromising the duty of confidentiality and without creating any brokerage relationship between the employing broker and the party the designated broker represents. In this situation, the role of the employing broker is to supervise and advise the broker associate. The duties of representation belong to the broker associate, even if the employing broker receives confidential information. The employing broker still has an obligation to make sure all representation contracts are fulfilled at the highest level.

Designated brokers must be careful to not provide information (actual knowledge) within the firm that violates confidentiality rules. Brokers should keep files secure and avoid sharing confidential information within the office because, at any time, another broker at the firm might represent the other party.

**Figure 1.5: Designated Brokerage****Application Note**

A broker designated to work with a buyer could show a property listed by another broker from the same brokerage company without a conflict of interest.

**In-Company Transactions Under Designated Brokerage**

An in-company transaction is when brokers from the same firm represent both parties to a single transaction. For example, one broker works as the listing broker and another broker from the same firm works as the buyer's broker for the listing. Under Colorado law, the designated broker working with one party is considered to be isolated from the confidential information learned by the other broker from the same firm. Without a brokerage relationship, no conflict arises.

A conflict arises if a broker is designated to provide services to both the buyer and the seller in the same transaction (double-ending) but has an agency relationship with one of the parties. As long as the single designated broker double-ending the transaction is a transaction-broker for both parties, there is no conflict of interest. Remember, a broker may not be an agent for one party and a transaction-broker for the other. The broker can change from agency status to transaction-broker status in order to double-end the transaction, but the principal(s) must give written permission first.

**Application Note**

A single broker designated to work with both the buyer and the seller has a conflict of interest unless both relationships are transaction-broker.

**EXAMPLE 1**

A broker has an agency listing, and another broker in the same office shows the property to a buyer and writes an offer. There is no conflict of interest because Colorado law provides that the buyer's broker does not automatically have imputed knowledge of the seller's confidential information.

**EXAMPLE 2**

A broker has an agency listing, and a buyer the broker represents wants to see the listing. Both parties may agree to allow the broker to double-end the transaction and act as a transaction-broker. The broker will then earn the commissions for both the listing and the buying sides of the transaction.

The broker could also resign the agency with one party by having an employing broker designate a different broker from the office to work with that party. In this case, the broker would not double-end the transaction, and the other broker would earn part of the commission. (The original broker could ask for and receive a referral fee.)

**Figure 1.6: Review of Comparison of Duties**

<b>Common Law Agent Duties</b>	<b>Colorado Limited Single Agent</b>	<b>Colorado Transaction-Broker</b>	<b>Colorado Customer</b>
<b>O</b> bedience	Yes	To the transaction	No
<b>L</b> oyalty	Yes	No	No
<b>D</b> isclosure	Full disclosure to principal—benefits and risks	Only material facts	Only material facts
<b>C</b> onfidentiality (PTM)	Yes (PTM)	Yes to both (if working with both) (PTM)	No
Price	Price	Price	
Terms	Terms	Terms	
Motivations	Motivations	Motivations	
<b>A</b> ccounting	Yes	Yes	Yes
<b>R</b> easonable skill and care	Yes	Yes	No—honesty
Created in Colorado by:	Written contract (Listing Contract or Buyer Representation Contract)	Default relationship when no written contract. Written disclosure required.	Written disclosure (Brokerage Disclosure to Buyer or Seller)

- Remember that the duties the broker owes depend on the type of relationship with the consumer:
  - Agent—OLD CAR
  - Transaction-broker—DCAR
  - Brokers owe customers—DAH (honesty)

## COLORADO BROKER'S LIMITED RIGHT-TO-PRACTICE LAW

Colorado brokers have the right to fill in approved or standard real estate contracts and explain their meaning to clients. The Colorado Supreme Court affirmed this right in the landmark decision of *Conway-Bogue Realty Investment Company v. Denver Bar Association*. The court found that brokers may perform this limited practice of law under certain conditions:

1. The brokerage firm must be connected with the transaction through a brokerage relationship. Brokers may not prepare documents for parties with whom they do not have a brokerage relationship; they must be acting as either an agent or a transaction-broker for either party. Brokers may assist customers with the forms in their role as an agent for a seller or buyer.
2. There must be no fee for preparing the documents other than a typical real estate commission. Part of the fee structure of a commission is the preparation of appropriate documents for that transaction; charging additional fees to prepare legal documents such as deeds and bills of sale is not acceptable.
3. The documents must be prepared on commonly used printed standard or approved forms.

Real estate licensees must recommend that consumers seek legal tax advice or other counsel when contracting. Licensees must also recommend, prior to the closing of a real estate transaction, that the consumer have an attorney examine the title. Buyers and sellers are not

required to use an attorney, but brokers must make it clear that brokers are not experts in certain areas, so the buyer or the seller may wish to consult with a lawyer.

In the landmark case *Colorado Bar Association v. The Title Guaranty Company*, the Colorado Supreme Court found that brokers using a title company's closing department may have the closing company prepare settlement sheets and other non-legal documents. Brokers appoint title companies as their *scrivener*, using the approved Closing Instructions form.

In 1971, the Colorado Real Estate Commission developed and approved a wide variety of forms to assist brokers in complying with the *Conway-Bogue* decision. Commission rules keep brokers in compliance with the *Conway-Bogue* decision by describing the forms and requiring that brokers use approved forms, when available, or a standard form, if not.

Brokers may not alter a form's standard language as it has been approved. A broker may add information identifying the brokerage firm when the forms are printed. If any approved provision of a form is deleted or struck out as directed by a party to the contract, it must be crossed out so the deleted words remain legible. For example:

- Acceptable: ~~This strikethrough is acceptable.~~
- Not acceptable: ~~This strikethrough is not acceptable.~~

All language the broker adds in blank spaces must be in italics or in different typeface or font than the preprinted language so the reader can tell the difference between the added language and the approved language.

Brokers are allowed to omit a group of specific provisions (e.g., financing terms) from the approved form when it is printed if those provisions do not apply to a particular transaction. However, it is important with all omissions that the reader of the document be made aware of the omitted item. The Commission requires that the caption or heading be retained and the word "OMITTED" be added after the caption.

- For example, to omit the Assumption subsection:

#### 4.6. Assumption. OMITTED

The full paragraph for assuming a loan would then be deleted from the contract

All approved forms must have a statement of Commission approval on the first page.

Example

The printed portions of this form, except differentiated additions, have been approved by the Colorado Real Estate Commission (insert form number).

"Differentiated additions" refers to any of the language brokers used in the blanks.

A principal to a contract can add, delete, or draft language to be added to the contract. A broker who is not a party to the contract (typically the Contract to Buy and Sell) may not add, delete, or draft personal provisions, personal disclaimers, or *exculpatory language* to the contract or in an addendum. Exculpatory language or clauses are those that a broker might use to try and limit liability. The broker could use this type of language in an employment contract, listing contract, or buyer representation contract in which the broker is a principal party to the contract.

Commission rules state that if a broker uses a preprinted or prepared addendum that modifies or adds to the terms of a Commission-approved contract form, and the addendum does not

result from the negotiations of the parties, the addendum must be prepared by an attorney representing the broker or brokerage firm, a principal to the transaction, or an attorney representing a principal party. A broker may not prepare these addenda because there were no negotiations between the parties. Brokers are allowed to translate what the parties are asking for into language that can be inserted into a contract such as “seller excludes the hot tub,” but a broker may not draft new language that the parties did not negotiate. An example would be adding a non-negotiated mold addendum to the Contract to Buy and Sell Real Estate. Any addenda used by a broker to explain or add to the terms of the approved form must be carefully prepared by one of the approved parties and must contain a disclaimer that the language of the addendum is not approved by the Colorado Real Estate Commission.

There are several excellent software programs available to complete and generate the approved forms. It is the broker’s job to verify that these software programs reproduce the Commission language exactly as approved. The software program must also have a security feature to prevent the user from altering the approved language or deleting part of the form.

The Commission has not approved forms for every possible type of transaction. For example, there are no approved lease forms or forms for the various types of conveyance deeds. Brokers may use standard forms available from office supply stores and legal printing companies for these documents. Brokers must use an approved form or standard form if one is available. Contract forms may not be filled out prior to negotiation with the party. Brokers must use the proper and most current form. To ensure this, it is the broker’s obligation to check the Commission’s website for the most recent forms, rules, and regulations.

Commission rules do not apply to contracts for new homes with warranties or those prepared by a subdivision developer. These two groups typically use contracts created by an attorney representing the seller or the developer. The Commission has not approved a form for an installment land contract, so it is recommended that brokers have it drafted by an attorney.

Attorneys do not fall under these rules and may prepare contracts for any party in the transaction or, if requested, for the brokerage firm in a specific transaction. But brokerage firms are not allowed to have their attorney prepare contracts for general use in the firm. For example, an employing broker could not have an attorney draft a contract to buy and sell for all of the firm’s brokers to use. Brokers must use the Commission-approved form. A party to the transaction may also prepare a contract or addendum, so the seller, the buyer, or an attorney for either party could draft a contract to buy and sell for a specific property.



## UNIT 1 LECTURE OUTLINE

### I. REAL ESTATE BROKERAGE IN COLORADO

#### A. Levels of broker authority

- The Real Estate Commission recognizes three levels of responsibility for brokers that are based on experience and additional education.
  1. An associate broker
    - a. is a licensee with \_\_\_\_\_ of active experience, or a licensee with two or more years of experience who has chosen not to upgrade a license to an independent or employing broker; and
    - b. must work under the supervision of an employing broker and will qualify as an independent broker after two years of active experience.
  - **Note:** Most real estate licensees work as associate brokers under an employing broker, no matter what experience or level of authority they have or could have.
  2. An independent broker
    - a. has a minimum of two years of active experience,
    - b. may work independently and be licensed as an individual or a business entity,
    - c. \_\_\_\_\_ other licensees, and
    - d. is not required to undergo additional education to upgrade to this license type.
  3. An employing broker
    - a. has a minimum of two years of active experience as appropriate to the area of supervision,
    - b. \_\_\_\_\_ other licensees, and
    - c. must complete an additional 24-hour course in brokerage administration.

#### B. Colorado brokerage relationships – representation of consumers

1. Agent
  - a. In Colorado, an agent's duties are the same fiduciary duties as those under the common law of agency (OLD CAR).
  - b. Any brokerage firm and broker acting as an agent \_\_\_\_\_ in Colorado. The two most common contracts are the Exclusive Right-to-Sell Listing Contract and the Exclusive Right-to-Buy Listing Contract.
  - c. A broker acting as an agent may only be a \_\_\_\_\_ in a single transaction, representing only one side.

- d. Under Colorado law, licensees may not act as a dual agent. (They may not represent both parties as an \_\_\_\_\_ in a single transaction.)
- e. An agent is an \_\_\_\_\_, promoting the interests of one party over the other. An agent \_\_\_\_\_, working for only one side of the transaction.

## 2. Transaction-broker

- a. A transaction-broker is not \_\_\_\_\_ for either party. A transaction-broker acts like a referee.
- b. The transaction-broker manages and is obligated to follow the directives of the party or parties the transaction-broker represents.
- c. A broker may represent one party as a transaction-broker (e.g., a seller's transaction-broker with an Exclusive Right-to-Sell Listing Contract), or a transaction-broker may represent \_\_\_\_\_ without a conflict of interest (double-end the transaction).
- d. A broker representing a consumer as a transaction-broker does not have all the fiduciary obligations that an agent has. Remember, this broker is simply \_\_\_\_\_ (facilitator), keeping both parties informed.
- e. Transaction-broker is the \_\_\_\_\_ relationship in Colorado; it does not require a written contract, only a written disclosure of responsibilities.
- f. However, without a written contract, the consumer is under no obligation to pay the brokerage.
- g. Transaction-brokers are required to confirm the representation responsibilities the broker owes to the consumer.
  - (1) This \_\_\_\_\_ is done either through an exclusive listing contract or a written disclosure form.
- h. A broker cannot act as a transaction-broker if the broker is unable to be neutral. For example, a broker typically cannot be a transaction-broker when representing
  - (1) themselves as a principal,
  - (2) a spouse or family member,
  - (3) a close personal friend or business associate, or
  - (4) repeat clients or multiple properties for the same client.

## 3. Customer

- a. Colorado law also defines a customer in a transaction as “a party to the real estate transaction with whom the broker has \_\_\_\_\_ or no representation, because such party has \_\_\_\_\_.”
- b. Typically, a broker would ask a potential buyer to be a customer when the broker's listing contract with the seller requires the broker to remain an agent (e.g. a listing broker representing her child as a listing agent).
  - (1) The broker cannot be an agent for the buyer in this transaction. (Remember, agents in Colorado are single agents—never dual agents.)

- (2) This would allow the broker to double-end the transaction and work with both the seller (principal) and buyer (customer) and get paid a full commission.
- (3) The broker would work with both parties but would represent only the seller; the buyer would be an unrepresented customer.
- c. The broker must disclose in \_\_\_\_\_ that the broker will continue to be the agent for the seller and have no brokerage relationship, or representation, with this “buyer customer.”
- d. The reverse situation could occur if the broker was an agent for the buyer and the buyer wanted to buy from an unrepresented seller (for sale by owner [FSBO]). The broker would need to use the Brokerage Disclosure to Seller (Sale by Owner) form.
- e. The single agent broker may do anything for a customer that does not compromise the agency contract with the principal.
- f. The duties licensees owe to a customer are (DAH)
  - (1) disclosure of material facts,
  - (2) accounting for money and property entrusted to the broker, and
  - (3) honesty.

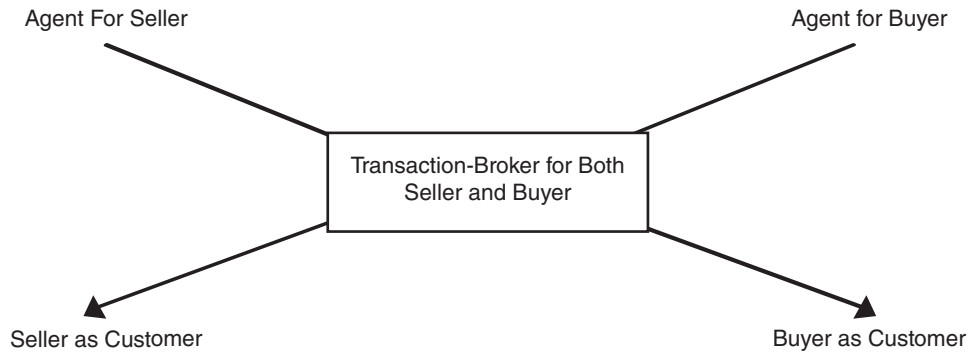
### C. Disclosing an existing relationship with a seller to a buyer

1. Receiving a fee from someone does not establish agency or any other relationship. The written contract, disclosure, or, at times, your actions determine representation and the brokerage relationship.
2. Definitions of Working Relationships disclosure form
  - a. Purpose: This disclosure form is a primary tool used to educate the public about the brokerage relationships available under Colorado law.
  - b. The form is not required for most transactions but provides a good introduction to the different relationships that are available.
  - c. A broker who has a written, signed exclusive representation contract to act as an agent or transaction-broker does not need this form unless the brokerage firm requires it to be part of the final transaction file.
  - d. Colorado law recognizes two brokerage relationships for a broker to \_\_\_\_\_ a member of the public: \_\_\_\_\_ and \_\_\_\_\_.
  - e. The employing broker's \_\_\_\_\_ details what the brokerage firm offers: either relationship (agency and transaction brokerage) or only certain choices.
    - (1) For example, the brokerage firm could choose to only offer transaction-broker relationships so no brokers in that firm could be an agent for a member of the public.
- Dual agency and subagency are not recognized real estate brokerage relationships in Colorado.
3. Brokerage Disclosure to Buyer form
  - a. Purpose: This form, like the Definitions of Working Relationships form, provides the Real Estate Commission definitions of the relationships brokers can have with sellers or buyers.

- b. This form is used to define the transaction-brokerage relationship when the buyer wants the default position with no signed contract, no obligation to pay a commission, and no agency relationship.
  - (1) Buyers should be informed that they can accept the disclosed relationship or seek an exclusive relationship with the licensee or another broker.
- c. This form is also used to make the buyer an \_\_\_\_\_ when the broker is an agent to the seller and wants to double-end the transaction.
- d. This disclosure is \_\_\_\_\_ if the broker has an existing representation relationship with a seller. The broker must disclose that relationship (agency or transaction-broker) to any unrepresented buyer who inquires about the seller's property.
- e. Remember that under a disclosed relationship (with no signed exclusive representation contract), a buyer could leave at any time and seek the services of another broker with no obligation to this broker.
- f. The broker checks the appropriate box on the form to disclose the type of brokerage firm (multiple-person or one-person firm) that the broker works for.
- g. If the broker has a representation relationship with the seller, the terms of the listing with the seller will dictate options the broker may offer the buyer (transaction brokerage or the buyer as a customer).
- h. The form makes it clear that the relationship the broker is disclosing is only for a particular property showing or for a property type.
- i. Customer: This box is checked if the buyer will always be a customer.
  - (1) The broker plans to show the broker's agency listing(s) to this buyer.
  - (2) The seller has requested, in the listing, that the broker remain the seller's agent for showings.
  - (3) The broker will have no contract to receive a fee from this buyer.
  - (4) The broker may assist the customer in any way that does not \_\_\_\_\_ the agency relationship with the seller.
- j. Customer for Broker's Listings – Transaction Brokerage for Other Properties: This second box is checked when the buyer may be a customer or the broker may represent the buyer as a transaction-broker, depending on the property being shown to the buyer.
  - (1) The broker will be a seller's agent for that broker's listings and a transaction-broker for all other properties the broker shows the buyer.
- k. Transaction Brokerage Only: The third check box is used when the following apply:
  - (1) The broker will be a transaction-broker for all showings of any property whether or not it is one of the broker's listings.
  - (2) It would create the default representation role without a signed exclusive contract.
  - (3) The buyer is informed that the cost and quality of settlement services can vary between different providers, attorneys, lenders, inspectors, and title companies.

### D. Double-ending transactions in Colorado

**Figure 1.7: Double-Ending a Transaction**



1. The listing contracts (which will be reviewed later) provide the broker and the principal two options they may negotiate if the broker gets the opportunity to double-end the transaction (when the broker works with both the buyer and seller in the same transaction).
  - a. The broker remains an agent for either the buyer or seller. In this case, the broker must treat the other party as a customer to work both sides of the transaction.
  - b. The broker can, with permission from a principal or principals (if working as an agent for both the seller and buyer), automatically change to a transaction-broker to work both sides of the transaction. This permission is given in the listing contract.
2. The law requires that if a broker has a brokerage relationship with both sides, the broker must treat both parties equally and must be a transaction-broker. Agents may represent only one party to the transaction.
  - a. The broker must change the status to a transaction-broker when working with both sides.
3. The other option is to resign one relationship, treat that party as a customer, and keep the other agency relationship.

### E. Disclosure of brokerage relationships and Commission requirements

1. The law \_\_\_\_\_ requires that \_\_\_\_\_ the following types of relationships they may provide to the public:
  - a. Representation (agent or transaction-broker)
  - b. Nonrepresentation (customer)
2. Brokers must also disclose any existing representation relationships they have to unrepresented consumers (e.g., a consumer attending the broker's open house).
3. Disclosure must be made before eliciting or receiving any \_\_\_\_\_ from the consumer.
  - a. Brokers are allowed to have rapport-building conversations without disclosing who they represent.
4. Disclosure \_\_\_\_\_ start orally in a phone conversation if the broker believes the consumer might divulge confidential information.

5. Disclosure \_\_\_\_\_ be in writing at the first physical contact with the consumer for the broker to be in compliance with the law.
6. Brokers must use one of two approved forms to meet the requirement of giving written disclosure (Brokerage Disclosure to Buyer or Brokerage Disclosure to Seller [Sale by Owner]).
7. The broker is not required to have the written disclosure form \_\_\_\_\_ with the law. If the member of the public declines to sign, the broker should note the person's name and date on the file copy and give a second copy with the broker's signature to the member of the public.
8. A broker must disclose to a buyer the broker's representation relationship with a seller. The license law also requires disclosing to an unrepresented seller that the broker has a representation relationship with a buyer.
9. Don't confuse \_\_\_\_\_; Commission rules state that the broker must give a written disclosure, not that the member of the public has to \_\_\_\_\_.

#### **F. Designated brokerage**

1. Under Colorado designated brokerage law, the brokerage firm acting through the firm's associate brokers agrees to provide a set of services to a seller, buyer, landlord, or tenant.
2. The brokerage firm \_\_\_\_\_ and elects to provide services by designating an associate broker to represent the principal in the contract.
3. The \_\_\_\_\_ of the firm designates an individual associate broker (or a team of associates) within the firm to enter into the brokerage relationship and represent a particular seller or buyer (or landlord or tenant).
4. In designated brokerage, the \_\_\_\_\_ stops with the \_\_\_\_\_ and does not extend to the rest of the brokerage firm or the employing broker.
5. The agency or transaction-broker relationship and its duties exist only between the seller or buyer and the designated associate broker.
6. The designation \_\_\_\_\_; typically this is done in the brokerage firm's written office policy.
7. If necessary, the brokerage firm can replace a designated associate broker or add another designated associate broker.
8. Colorado designated broker provisions allow a designated associate broker to seek the advice of an employing broker and share information about a client with the employing broker without compromising the duty of confidentiality and without creating any brokerage relationship between the employing broker and the party the designated broker represents.
9. Designated associate brokers must not provide information (actual knowledge) that violates confidentiality rules to other associates within the firm.

#### **G. In-company transactions under designated brokerage**

1. An in-company transaction is when two brokers from the same firm represent both parties to a single transaction.
  - a. For example: One broker works as the listing broker and another broker from the same firm works as the buyer's broker for the listed property. Each broker has a separate brokerage relationship with the party the broker represents.

- b. Because there is no transfer of confidential information, no brokerage relationship or conflict arises.
- 2. In-company: multiple brokers—no conflict
  - a. A broker designated to work with a buyer could show a property listed by a broker from the same firm without a conflict of interest.
- 3. A conflict arises if a broker is designated to provide services to both buyer and seller in the same transaction (double-ending the transaction) and has an agency relationship with at least one party.
  - a. As long as the single designated broker double-ending the transaction is or can become a transaction-broker for both parties, there is no conflict of interest.
    - (1) Remember that a broker may not be an agent for one party and a transaction-broker for the other.
  - b. The broker can change from agency status to transaction-broker status and resolve such a conflict in order to double-end the transaction. The principal(s) must give written permission for the change of status.
- 4. In-company: one broker (agent for at least one)—conflict
  - a. A single broker designated to work with both the buyer and seller has a conflict of interest unless both relationships are transaction-broker.
- 5. Example 1: A broker has an agency listing, and another broker in the firm shows the property to a buyer and writes an offer. There is no conflict of interest because Colorado law provides that the other broker does not automatically have imputed knowledge of the seller's confidential information.
- 6. Example 2: The broker has an agency listing, and a buyer the broker represents wants to see the listing.
  - a. Both parties may agree to allow the broker to double-end the transaction and work with both parties as a transaction-broker. The broker may then earn the commissions for both the listing and selling sides of the transaction.
  - b. The broker could also resign the agency with one party by having an employing broker designate a different broker from the firm to work with that party. In this case, the broker would not double-end the transaction, and the other broker would earn part of the commission (but the original broker could ask for and receive a referral fee).
  - c. The approved listing contracts have a provision for the seller and broker to agree, in advance, how this situation will be handled.
- 7. Remember, the duties brokers owe depends on the type of relationship:
  - a. Agent—OLD CAR
  - b. Transaction-broker—DCAR
  - c. Brokers owe customers—DAH (honesty)

## II. REVIEW OF A BROKER'S LIMITED RIGHT-TO-PRACTICE LAW

### A. *Conway-Bogue* Supreme Court decision

1. Gave brokers the right to practice limited law
  - a. The brokerage firm must be connected to the transaction through a brokerage relationship.
    - (1) Brokers may not prepare documents for parties with whom they do not have a brokerage relationship. They must be acting as agents or transaction-brokers. Agents may assist customers with the forms in their roles as an agent for a seller or buyer.
  - b. There must be no fee for preparing the documents other than the normal real estate commission.
    - (1) Part of the fee structure of a commission is the preparation of appropriate documents for that transaction; charging additional fees to prepare legal documents, such as deeds and bills of sale, is not acceptable.
  - c. The documents must be prepared on commonly used printed standard or approved forms.
    - (1) Real estate brokers must recommend the use of attorneys to their clients and customers in real estate transactions. Buyers and sellers are not required to use an attorney, but brokers must make it clear that they are not experts in certain areas, so the buyer or seller may wish to consult with a lawyer.
    - (2) Title insurance companies often assist brokers, sellers, and buyers in preparing closings. They may prepare settlement sheets and other documents authorized by the buyer and seller, such as deeds and bills of sale.
    - (3) Buyers and sellers appoint title companies or brokers to complete these legal documents in the Closing Instructions form.
    - (4) A real estate licensee must also recommend, prior to the closing of a real estate transaction, that an attorney examine the title.

### B. Standard and approved forms

1. In 1971, the Colorado Real Estate Commission developed and approved a wide variety of forms to \_\_\_\_\_ in complying with the *Conway-Bogue* decision.
2. Commission rules keep brokers in \_\_\_\_\_ with the *Conway-Bogue* decision by using the approved forms when applicable.
3. The CREM details the “permitted and prohibited form modifications” in the Commission rules.
  - a. Brokers must use a Commission-approved form when such form exists and is appropriate for the transaction.
    - (1) Brokers may add information identifying the brokerage firm on a Commission-approved form.
    - (2) Any deletion or modification to the body of a Commission-approved form must be made directly on the body of the form in a legible manner that does not obscure the deletion that has been made. For example:  
 Acceptable: ~~This strikethrough is acceptable.~~  
 Not acceptable: ~~This strikethrough is not acceptable.~~



- (3) The reader should be able to determine what was removed.
  - (4) Language added in blank spaces must be in \_\_\_\_\_ or font than the preprinted language so the reader can tell the difference between the language added to the blanks and the Commission-approved language.
4. Certain specific provisions may be omitted from the approved form if those provisions do not apply to a particular transaction. In the event any provision is deleted, the caption or heading must remain unaltered and should be followed by the words “OMITTED—NOT APPLICABLE.”
- a. For example, to omit the following sections, it would look like this:

Section 2.5. Inclusions. OMITTED—NOT APPLICABLE

Section 4.6. Assumption. OMITTED—NOT APPLICABLE

5. Approved forms must have a statement of Commission approval on the first page: The “differentiated additions” (in the text that follows the statement) are words filled in the blanks in a different type style.

Example: The printed portions of this form, except differentiated additions, have been approved by the CREC (insert form number). \*\*Use different type style for form number in example.

- 6. The “differentiated additions” refers to the words filled in the blanks in a different type style.
- 7. Commission rules require that the additional provisions section of any form include only transaction-specific agreements \_\_\_\_\_ between the parties.
  - a. The section must be labeled: “The following additional provisions have not been approved by the Colorado Real Estate Commission.”
- 8. A broker who is not a party to the contract \_\_\_\_\_ add personal provisions, personal disclaimers, or exculpatory language in an addendum.
- 9. Exculpatory clauses are used to try to limit the broker’s liability in a transaction. These would, however, be acceptable in an employment (representation) agreement where the broker is a party.
- 10. Addenda
  - a. If a broker uses a preprinted or prepared addendum that modifies or adds to the terms of a Commission-approved contract form, and the addendum \_\_\_\_\_ of the parties, then such an addendum must be prepared by one of the following:
    - (1) An attorney representing the broker or brokerage firm
    - (2) A principal to the transaction
    - (3) An attorney representing a principal party
  - b. Such addenda may not be prepared by the \_\_\_\_\_ for the parties.
  - c. The broker must retain the addendum for four years from the last date the addendum was used.
  - d. The broker must be able to provide the Commission with the name of the attorney or law firm that prepared the addendum upon request.

11. Computer-generated contract forms may be used.
  - a. Several excellent software programs are available to complete and generate the approved forms.
  - b. These software programs must reproduce the Commission language \_\_\_\_\_ as approved.
  - c. The software program must have a security feature to prevent the user from altering the approved language or deleting part of the form.
12. The Commission has approved forms for several types of conveyance deeds (there is no approved form for bargain and sale deeds, personal representative deeds, etc.).
  - a. Brokers may use standard forms available from office supply stores and printing companies for leases and other forms.
13. Contract forms may not be filled out prior to \_\_\_\_\_ with the party.
14. Brokers must use the proper form.
15. Commission rules do not apply to the following:
  - a. Contracts for \_\_\_\_\_
  - b. Contracts prepared by a subdivision developer
16. An installment land contract form has not been approved by the Commission, so it is recommended that brokers have one drafted by an attorney.
17. Attorneys do not fall under these rules and may prepare contracts for any party in the transaction or for the brokerage firm in a specific transaction.
  - a. A brokerage firm is not allowed to have its attorney prepare contracts for \_\_\_\_\_ in the firm. All real estate licensees must use Commission-approved forms.
18. A party to the transaction may also prepare a contract or an addendum.

# UNIT 1 REVIEW EXAM

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*This exam is not graded. Please complete it before studying Unit 3.*

1. Signatures are acknowledged to show that the document
  - A. was accepted and recorded.
  - B. is now valid.
  - C. was signed under duress.
  - D. is signed properly.
2. The Supreme Court decision in the *Conway-Bogue* case relating to the practice of law by real estate brokers stated that
  - A. only attorneys may complete standard forms.
  - B. Colorado licensees may complete standard or approved forms in a real estate transaction.
  - C. Colorado licensees may draft any forms needed for a real estate transaction.
  - D. attorneys are not trained to review real estate transactions.
3. The purpose of Commission rules relating to approved forms is to
  - A. help ensure the broker's compliance with the *Conway-Bogue* decision of the Colorado Supreme Court.
  - B. assist attorneys in handling real estate transactions.
  - C. require that all real estate transactions be completed using the same form.
  - D. prohibit the use of addenda to add material to standard forms.
4. A transaction-broker is *MOST* like
  - A. an advocate.
  - B. a fiduciary.
  - C. a professional coordinator.
  - D. a coach.
5. The listing broker has requested that the title company complete a deed and bill of sale for closing. The responsibility to pay for these documents belongs to
  - A. the buyer's broker.
  - B. no one; the title company provides them as part of the closing.
  - C. the lender.
  - D. the seller's listing broker.
6. A broker is representing both parties in the transaction. Her relationship with the parties is *MOST* likely
  - A. a transaction-broker for both parties.
  - B. an agent for the seller and a subagent for the buyer.
  - C. treating both as disclosed customers.
  - D. a dual agent.
7. All of the following are essential elements of every contract *EXCEPT*
  - A. mutual agreement.
  - B. competent grantor.
  - C. lawful objective.
  - D. consideration.
8. Which of the following would constitute steering?
  - A. Showing only areas the buyer has requested
  - B. Showing areas the buyer can afford
  - C. Showing a buyer with children areas that only have children
  - D. Showing a senior housing for those over 55 years of age
9. An associate broker is required to
  - A. work for an employing broker for two years before becoming eligible to be an independent broker.
  - B. work for an employing broker for two years, then change her license to independent or employing broker.
  - C. have an active or inactive license for two years and then become an independent broker.
  - D. work under an employing broker or independent broker who has had a license for at least four years.
10. A broker is asked to complete the Contract to Buy and Sell for his neighbors, who tell him that they will complete all the other tasks for closing. The broker should
  - A. first establish a set fee for the document preparation.
  - B. tell the buyer and the seller they must first engage him as a scrivener.
  - C. draft the contract and ask for a fee equal to a percentage of the sales price.
  - D. complete a representation contract or disclosure before completing the paperwork.

11. When a Colorado licensee completes the blanks in a Commission-approved form, this
  - A. is the practice of law and must be done by attorneys.
  - B. is not the practice of law.
  - C. must be done entirely with preapproved standard clauses.
  - D. is the practice of law but is specifically permitted by Colorado law.
12. Independent brokers are authorized to do which of the following under Colorado law?
  - A. Only work independently, not in the employ of another broker
  - B. Work in the employ of another broker, work independently, or hire and supervise no more than five other licensees
  - C. Work independently without the supervision of another broker
  - D. Act as a broker for a corporate brokerage as long as there is a qualified employing broker available for supervision and training of associated licensees
13. A designated broker representing a seller
  - A. has vicarious liability for acts of the principal.
  - B. has a duty to investigate the condition of the property.
  - C. is the only broker in the company with a brokerage relationship with the seller.
  - D. has a brokerage relationship with the principal and the employing broker.
14. In an in-company transaction where the employing broker has designated one broker to work with the buyer and another to work with the seller, the brokerage relationship will be between
  - A. each designated broker and the party the broker represents, not the employing broker.
  - B. both brokers because they must be transaction-brokers.
  - C. the brokers and the employing broker who must supervise them.
  - D. the designated broker and the employing broker only if there is a need for supervision.
15. A buyer in a transaction may be a customer if the buyer
  - A. actually buys the home.
  - B. is not represented by any broker.
  - C. has no written contract.
  - D. wishes to see a property listed with the firm.
16. An employing broker supervising broker associates must
  - A. provide classes to promote competency.
  - B. require that the broker associates join a board of REALTORS®.
  - C. provide mentors to attend their closings.
  - D. have the broker associates agree to and sign the office policy.
17. A broker using the approved Contract to Buy and Sell wishes to print only part of the financing options in the form. In this case, the broker
  - A. may not omit any approved language or terms.
  - B. must add "OMITTED" to the section head being removed.
  - C. may be violating Commission rules by failing to print the full form.
  - D. may print the form without the options and does not need to add any further language.
18. The employing broker for a brokerage firm designates an associate broker to perform services for a buyer. The brokerage relationship will be with
  - A. the employing broker.
  - B. the employing and designated broker.
  - C. only the designated broker.
  - D. all the brokers in the office.
19. A broker using a form generated by a computer program must
  - A. use a program approved by the Real Estate Commission.
  - B. scan a form into a word processing program.
  - C. use a program with security that will not allow the form to be changed inadvertently or intentionally.
  - D. retrieve the form from the Commission website.
20. Colorado does not recognize dual agency, but one broker may work with both the seller and the buyer in a transaction if the broker is
  - A. an agent.
  - B. a customer.
  - C. a transaction-broker.
  - D. an agent, dual agent, or facilitator.

# ANSWER KEY AND RATIONALES FOR UNIT 1

## REVIEW EXAM

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*The exam answers and rationales are provided as a study aid to use after responding to the questions. Please complete the exam before referring to the answers.*

1. **D** The answer is is signed properly. Acknowledging a signature before a notary public shows that the signature is valid and was provided willingly.
2. **B** The answer is Colorado licensees may complete standard or approved forms in a real estate transaction. This court decision is the basis for the way real estate business is done in Colorado.
3. **A** The answer is help ensure the broker's compliance with the *Conway-Bogue* decision of the Colorado Supreme Court. The Commission created this rule and the mandatory, approved forms to assist licensees.
4. **C** The answer is a professional coordinator. A transaction-broker coordinates from a neutral position and is not an advocate or a fiduciary to either party.
5. **D** The answer is the seller's listing broker. The broker who requested the documents must pay for them and may not charge the seller or the buyer.
6. **A** The answer is a transaction-broker for both parties. Colorado law permits a broker to have a brokerage relationship with both parties as a transaction-broker. Dual agency is not permitted, and a broker may not be agent for one party and transaction-broker for another in the same transaction.
7. **B** The answer is competent grantor. A grantor is a party to a deed and is not a party to "every" contract, such as a lease.
8. **C** The answer is showing a buyer with children areas that only have children. Restricting a buyer's selection of properties based on the fact that the buyer has children would violate federal fair housing law because familial status is a protected class.
9. **A** The answer is work for an employing broker for two years before becoming eligible to be an independent broker. Once licensed, a new associate broker must work under the supervision of an employing broker for at least two years before becoming eligible for independent broker status.
10. **D** The answer is complete a representation contract or disclosure before completing the paperwork. Per *Conway-Bogue*, the brokerage firm must be connected with the transaction through a brokerage relationship. This means brokers may not prepare documents for parties with whom they do not have a brokerage relationship. A broker must be acting as an agent or transaction-broker. An agent may assist a customer with the forms in his role as an agent for a seller or a buyer.
11. **D** The answer is is the practice of law but is specifically permitted by Colorado law. The landmark *Conway-Bogue* decision of the Colorado Supreme Court stated that filling out standard or approved forms is the authorized practice of law by real estate brokers.
12. **C** The answer is work independently without the supervision of another broker. A qualified independent broker may work independently but is not limited to that status.
13. **C** The answer is is the only broker in the company with a brokerage relationship with the seller. As a designated agent, the broker has the duty of full disclosure to the principal. The brokerage relationship is only between the designated broker and the seller. The employing broker has no brokerage relationship.
14. **A** The answer is each designated broker and the party the broker represents, not the employing broker. In this in-company transaction with two brokers, the employing broker has no conflict of interest because each broker is the sole holder of the confidential information within the relationship. There is no transfer of confidential information to the employing broker or other brokers in the firm.

15. **B** The answer is is not represented by any broker. The buyer may be a customer if the buyer is not represented by any broker. A broker working with this buyer must disclose in writing the fact that the buyer has not hired a broker and is a customer.
16. **D** The answer is have the broker associates agree to and sign the office policy. Employing brokers must have all associates, regardless of experience, agree to and sign the office policy.
17. **B** The answer is must add "OMITTED" to the section head being removed. Brokers are allowed to remove certain sections from approved forms but must leave the section head and add OMITTED.
18. **C** The answer is only the designated broker. Colorado law specifies that the employing broker must appoint a designated broker to perform services on behalf of the firm and hold the brokerage relationship with the seller, the buyer, the landlord, or the tenant.
19. **C** The answer is use a program with security that will not allow the form to be changed inadvertently or intentionally. Computer-generated form programs must contain security to prevent the user from changing the standard wording of the form.
20. **C** The answer is a transaction-broker. A transaction-broker may work with both parties in a single transaction without a conflict of interest.

# UNIT 2

## The Seller and Buyer Relationship

### OVERVIEW OF REPRESENTATION CONTRACTS

When a brokerage firm and its licensees are hired to represent a consumer, the firm uses personal representation or employment contracts. These contracts are typically called listings, and the most common type for sellers and landlords is an Exclusive Right-to-Sell Listing Contract or Exclusive Right-to-Lease Listing Contract. For buyer or tenant representation, the firm typically uses an exclusive right-to-buy or a tenant representation contract. Most states require that firms and real estate professionals use standard or approved forms and allow licensees to fill in the forms but not create or draft them. Colorado brokers may use four approved representation forms and two approved addendums (exclusive agency or open listing).

These representation contracts establish the brokerage relationship (agency or transaction brokerage) and spell out the obligations and duties of each of the parties. Because these are personal service or employment contracts, they can be terminated by either side if one party fails to perform. It is important to note that agency contracts belong to the firm, not the individual associate broker who found the employer (e.g., seller or buyer). This means that the employing broker can replace the original associate broker who brought in the listing with another of the firm's associates. It also means that the death of an individual associate broker will not terminate a contract. "Death" of the firm or, in some cases, employing broker or seller/buyer will terminate the contract.

### Required Elements of Representation Contracts

Representation contracts need to have the essential elements of competent parties, meeting of the minds, acceptance, a lawful objective, and consideration to be valid and enforceable. Because these documents are not being used to transfer real property, there is no statute of frauds requirement for them to be in writing like there is with a long-term lease, purchase contract, or any other contract used to transfer real property. In most states, including Colorado, if oral listing contracts are used, they are not enforceable in court. Therefore, most brokerage firms will require licensees to use written listing contracts to assure payment (express written contracts).



Due to the expense of marketing property, a broker or firm would rarely take an oral listing. However, real estate professionals often work with buyers with no written contract. This means that if the buyer buys a property from another firm, the first broker has no recourse to seek payment. A written representation contract is the best protection for real estate professionals anytime they are working with a consumer.

Typically, the representation contract starts with a heading section that sets the date of the contract. This is the reference date (e.g., June 3, 20--). No matter what date is on the signature line when the contract is signed by the parties, the first date in the document is how the contract is referred to going forward. In essence, it creates this form's name to separate it from other forms. If the contract needed to be modified, the amendment would state, "re: listing contract dated June 3, 20--," so all parties could be clear on what document and form are being modified. After the date section, the parties to the contract are named and assumed to be competent. Remember, it is the broker's job to make sure only competent (over 18 years old, sane, and sober) parties sign the contract. It is important that all owners with an ownership interest be named and sign the listing contract. Without this, the firm would only be able to sell the interest of the person listed, not the full property. This is also true for buyer representation contracts; all buyers who must be part of making the buying decision should be listed.

The name of the brokerage firm and the firm's representative who will be signing the representation contract are listed. (This is usually the broker who will be selling the property.) Often, the seller and the buyer are asked to verify that this listing or buyer representation is exclusive to the firm and that the seller or the buyer has no other concurrent listing. One of the main functions of the contract is to establish the form of brokerage relationship the firm will offer to the seller or the buyer. In Colorado, the firm can work with the seller or the buyer by being an agent or transaction-broker, or with the agent having the ability to become a transaction-broker if double-ending the transaction. The role the firm and its associates may have is first established by the firm's written office policy and then within the contract. For example, if the firm offers only single agency, the brokerage and broker who listed a property could not work as a transaction-broker representing a buyer in the sale of the listing.

The price of the listing or the amount the buyer is willing to pay is listed along with the duration or term of the contract. All representation contracts must have a definite termination date; in most states, including Colorado, it is not acceptable to use an automatic extension. If the broker has not been successful by the end of the term of the contract, the seller or the buyer must be asked to extend the term of the contract in writing.

Compensation is established through negotiation with the seller or the buyer and stated in the listing contract. In the seller listing, the seller may agree to allow the firm to offer cooperative compensation to other firms through a multiple listing service (MLS) system. This means that the listing broker may give up a significant portion of the commission to pay to another broker who brings a buyer for the property. For example, if the listing fee is 6% and the brokerage offers a 3% co-op fee, the commission will be split in half if a cooperating broker brings the buyer. It is the cooperation fee that is typically used to pay the buyer's broker fee. Depending on the contract, the buyer's broker will often seek payment from the seller and the listing broker before asking the buyer to pay.

The contract lists the duties required from the firm to earn the commission, as well as the obligations of the client. One duty is to maintain confidentiality. Associates must take care not to disclose any confidential information about the party they represent.

Real estate professionals are allowed a certain amount of "puffing" but should be very careful that puffing does not become fraud or misrepresentation. Stating that "this house has the best views in town and I think you are going to love it" is clearly an example of puffing that



most parties would recognize as opinion, not fact. But stating that “all the students in this neighborhood are in the top percentile and we have the best schools” is a researchable fact and should be stated only if the broker has proof it is true.

Brokers must be careful in their dealings not to misrepresent or omit facts that are pertinent to the property or parties. In particular, the brokerage firm and its associates must disclose all known material facts about the property to all parties. Licensees are held to a higher standard and are expected to be knowledgeable about basic real estate facts. A broker would be expected to notice and disclose that there might be structural damage or other issues that a physical inspection of the property would uncover. Typically, the firm and its associates are not required to have the property professionally inspected and may depend on the seller’s disclosure to uncover latent (hidden) material defects. For example, a broker completing a visual inspection of the property notes that the deck rails are loose and the foundation has a crack. The broker also asks the seller if there are any issues with the electrical, water, or sewer systems. The seller states that the systems are fine and, in the property disclosure, lists some other minor items. After closing, the buyer rescinds the contract after discovering that the home’s sewer system has not been functioning for months—a fact the seller clearly knew. In this case, the broker would not be liable because the failed system was a latent defect, and the seller did not disclose it in the property disclosure or when asked.

Most contracts also include a broker protection clause that begins and continues for a set period after expiration of the listing. The clause states that, upon expiration of the listing, if the seller sells the property to any interested buyer to whom the firm had shown the property and notified the seller of the showing, then the seller agrees to pay the firm a commission. This clause is typically eliminated if the seller lists the property with another firm. A similar protection contract is used in the buyer representation contract.

Mediation of disputes is part of Colorado law, and a section is used to describe the parties’ rights under mediation. It also covers the rights of the parties if mediation does not solve the issue.

One of the last sections contains a statement defining the contract as the total and final agreement between the parties, alerting the parties to verify that all oral agreements have been put in writing and are contained within the contract. Signature lines and dates complete the contract.

Three main contracts are used in Colorado to create agency relationships. The Exclusive Right-to-Sell Listing Contract is used to list property for sale. The Exclusive Right-to-Buy Listing Contract is used to represent the buyer in a purchase. (An Exclusive Right-to-Lease Listing Contract would be used with a tenant.) A property management agreement/contract is also used by the brokerage firm and the property owner to establish the agency relationship for the firm’s management of the owner’s property. There is no approved property management agreement/contract, however, because each property and the duties of the manager are considered unique.

## SELLER REPRESENTATION CONTRACTS

Brokerage firms can work with sellers using an exclusive right-to-sell contract, which means that no matter who sells the property (e.g., broker, seller, or seller’s neighbor), the brokerage firm will be paid the agreed-upon commission. Exclusive agency contracts allow the broker to offer the property in cooperation with other brokerage firms and still get paid. However, if the seller personally sells the property, the firm would not be paid. In an open listing, the seller agrees to pay any firm that *procures* (i.e., finds and provides) a buyer and brings an acceptable offer. All contracts are similar in that once the firm (through the broker) has obtained a ready,

willing, and able buyer who has made an acceptable offer to the seller, and the seller has accepted the offer, the firm has earned the commission. Typically, the commission is paid when the sale closes. If the listing firm brought the seller a full-price offer that met all the criteria of the seller for terms, timing, and so on, and the seller turns it down, the listing firm would still earn a commission. It is important to note that the firm could choose to sue the seller for this compensation. This rarely happens, but it is an important concept to understand when working with real estate employment contracts.

Within the listing contract, the property to be sold is clearly defined. In a typical listing, the street address, informal description, and formal legal description are inserted. In a listing and purchase contract, the property is typically defined as the real property described in the legal description, along with all appurtenances, improvements, rights, and fixtures currently attached to the property. Any personal property to be conveyed is listed separately. Remember that two documents are required to transfer these two different types of property: a deed and bill of sale. The deed will use the legal description from the listing and purchase contract, unless an error is found in the title work. The bill of sale must list all personal property items being conveyed; therefore, it is important for the listing broker to make sure the seller understands the difference between a fixture and personal property. Fixtures must be excluded by contract if the seller is not going to convey them. Personal property must be included in the purchase contract to be sold even if the items are listed in the listing contract, MLS, and other marketing materials. Unless these items are also excluded or included in the purchase contract, they will or will not convey at closing. The purchase contract is the final statement for exclusions and inclusions in the sale and is used to create the closing documents.

Brokers, as part of their due diligence, should inspect the property and look for material defects needing disclosure, as well as any items that the seller might not understand (under law) run with and will convey with title to the property. Upon seeing an installed (attached) hot tub, the listing broker should ask the seller whether it is the seller's intention to convey the fixture with the property or exclude the item. The listing contract has a place to list all exclusions of fixtures or other real property items the seller is not going to convey. If the seller does not exclude the item and then removes it after closing, the seller will be in breach of contract. All personal property the seller is going to include should also be listed. For the most part, this list of exclusions and inclusions should be reflected in the purchase offer. The buyer, of course, has the right to negotiate to buy any items excluded and can refuse to take possession of those the seller wants to include.

For example, the seller excluded the hot tub but included the washer and dryer in the listing. The buyer owns a better washer and dryer, so she did not list the appliances as part of the offer in the purchase contract; however, the buyer wants the hot tub to convey as part of the sale and has made that request in the offer. These items will now be negotiated between seller and buyer until a final agreement is reached.

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Colorado law states: "Facts or suspicions regarding circumstances occurring on a parcel of property which could psychologically impact or stigmatize such property are not material facts subject to a disclosure requirement in a real estate transaction."

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Stigmatized property is not considered a material fact under Colorado law, so disclosure is not required. Stigmatized property refers to property that may have a bad reputation because of events that happened there, such as a suicide, murder, or crime. These may be psychological "defects," but they are not physical defects in the property. A stigmatized property can only be disclosed by the listing broker with the seller's written permission; therefore, a listing broker is not held liable by the Real Estate Commission if it is not disclosed. A broker representing a buyer does not need permission to disclose stigmatized property issues. The broker should not disclose any personal information about the party being represented, unless the information has a material impact on the transaction (e.g., a buyer has poor credit).

The contract typically defines the duties of the brokerage firm and its brokers, including marketing activities the firm agrees to provide. If the firm or broker fails to meet these

obligations, the seller may terminate the listing. The seller can choose whether to allow the firm to notify others that current offers are being reviewed through a statement in the contract. Also, the contract should clearly establish whether the seller allows disclosure of any terms in regard to the seller's confidential information (e.g., price, terms, motivation). If the seller says to the broker, "I am motivated and will look at all offers," the broker should verify in writing that the firm may use this language in advertising. The broker would be in breach without the seller's informed consent (typically written permission) if the broker advertised: "seller willing to take all offers."

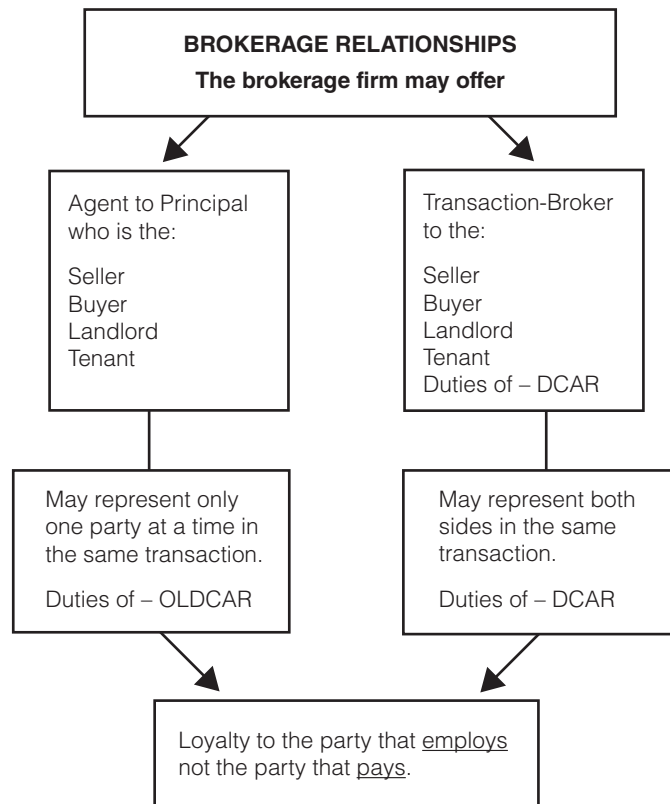
The contract defines the seller's duties and obligations for showings and supplying needed documents and disclosures. Most often, the listing requires the seller to complete separate disclosure documents to cover the requirement to disclose all material facts about the property and lead-based paint, if required. The seller, brokerage firm, and firm's associates also agree not to discriminate in the sale of the property based on classes protected under federal, state, and local fair housing laws. The most stringent fair housing law prevails; therefore, if the city law is more protective, it is the law all parties must follow.

## BUYER REPRESENTATION CONTRACTS

These contracts have very similar elements to the listing contract: naming of the parties, establishing what the contract is for and how payment will be earned, the duties of each party, and what type of brokerage relationship will exist between the buyer and the seller. While the property is clearly known and can be defined in the listing contract, the buyer contract uses a general description of what the buyer is seeking. For example: "Single family homes below \$200,000 in Smithville." As discussed earlier, the firm typically receives a success fee as part of the cooperative MLS contract and is paid by the listing brokerage at closing. The buyer can agree to pay or not pay the brokerage fee if this type of compensation is not available (i.e., the property is a for-sale-by-owner listing with no offered commission). Buyers are also given an option not to pay the firm. Just as with a listing, buyers can also have a nonexclusive or buyer agency listing that would allow them to find and buy a property on their own without owing the buyer's agent a fee. Buyers also sign to agree to abide by fair housing law.

## FORMING BROKERAGE RELATIONSHIPS

- Brokers normally get paid a commission for assisting a seller or a buyer in a real estate transaction.
- Brokers may be hired by a seller, buyer, landlord, or tenant.
- Brokers may be hired as an agent or a transaction-broker by any of these parties.
- Brokers in a brokerage relationship owe their obligations to the party that employs them, not the party that pays them.

**Figure 2.1: Brokerage Relationships**

## Representation Relationships

- Colorado brokers may represent an owner or a buyer as an agent or transaction-broker in the sale, purchase, or lease of property.
- Brokers must use the proper form to establish the relationship, as determined with the seller, buyer, landlord, or tenant, and according to their employing broker's written office policy.

## Representation Forms

- Seller representation can be created using the approved listing form called the Exclusive-Right-to-Sell Listing Contract. It has two approved addenda—one is used to create an exclusive agency listing and the other is for an open listing.
- Buyer representation can be created using an Exclusive Right-to-Buy Listing Contract.
  - These two forms will be covered in this unit. The forms are in the *Colorado Contracts and Forms Supplement*.

## Leasing Forms

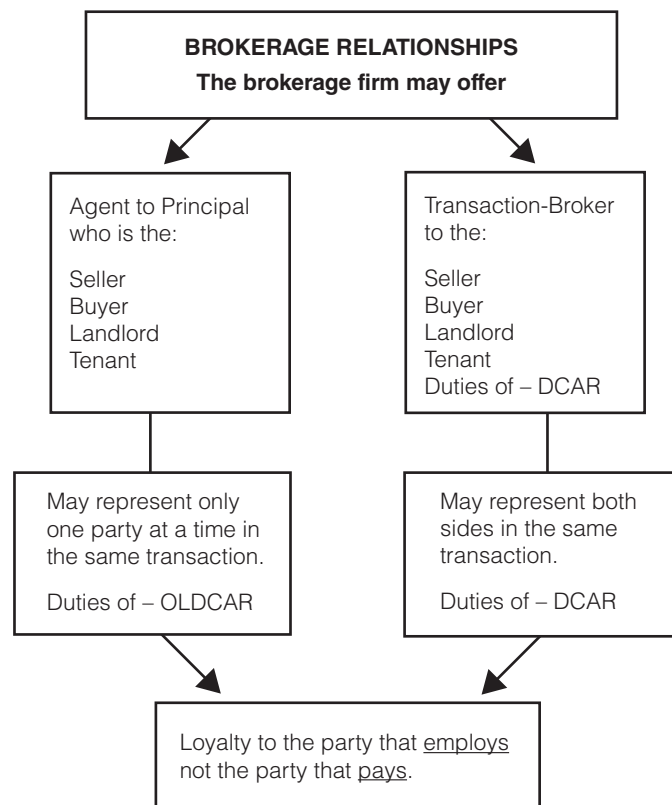
- Exclusive Right-to-Lease Listing Contract
- Exclusive Tenant Contract
  - These two forms can be found on the Commission website at <https://dre.colorado.gov/real-estate-broker-contracts-and-forms>

## UNIT 2 LECTURE OUTLINE

### I. FORMING BROKERAGE RELATIONSHIPS

1. A broker normally receives a commission for assisting a seller or buyer in a real estate transaction.
2. A broker may be hired by a seller, buyer, landlord, or tenant.
3. Brokers may be hired as an agent or transaction-broker by any of these parties.
4. Brokers in a brokerage relationship owe their obligations to the party that \_\_\_\_\_ them, not the party that \_\_\_\_\_ them.

**Figure 2.2: Brokerage Relationships**



### II. UNDERSTANDING THE EXCLUSIVE RIGHT-TO-SELL AND EXCLUSIVE RIGHT-TO-BUY LISTING CONTRACTS

#### A. Headings

1. The disclosures at the top of the form should always be reviewed with the buyer or seller. While these are standard to brokers, they are new to most buyers and sellers.
2. Additionally, the disclosures keep the licensee in compliance with the law and provide full disclosure to the parties.
3. The employment or representation relationship (agent or transaction-broker) will be decided between the designated broker and the seller or buyer based on the brokerage firm's office policy.

4. In small print, the form confirms that compensation to brokerage firms is established by each brokerage firm.
5. The check box will determine how the broker will represent the seller or buyer, either in an \_\_\_\_\_ relationship.
6. The date will be the contract reference date for this document.

**B. Agreement**

1. This section is used in contracts to define who the contract is between and establish what the contract is for.
2. It informs sellers or buyers that they are entering into a binding contract with the brokerage firm.
  - a. “Exclusive” means the sellers or buyers agree to work through this brokerage firm during the term of the listing.
  - b. “Irrevocable” means that even if the sellers stop marketing their property (withdraw the listing) or the buyers decide not to buy a property that meets the agreed-upon description, the sellers or buyers may still owe a \_\_\_\_\_ or the reimbursement of broker expenses.

**C. Broker and brokerage firm**

1. Brokerage firms are either multiple-person firms or one-person firms. The firm type will determine which box is checked.
2. This section sets up and creates designated brokerage, which only applies to multiple-person firms.
  - a. In a multiple-person firm, the employing broker will designate a broker or team to represent the seller or buyer.
3. Multiple-person firm
  - a. In a multiple-person firm, the brokerage firm designates one or more individuals to represent the seller or buyer. The individual(s) is(are) now identified as “broker(s).”
  - b. The designated brokerage relationship only exists with this broker and not with the brokerage firm or other associates of the brokerage firm.
4. One-person firm
  - a. In a one-person firm, the broker \_\_\_\_\_ and the firm (one person) is either a single agent or transaction-broker for the seller or the buyer.
5. For the first two years, a new licensee can only choose box a. because new brokers must be part of a multiple-person firm.

**D. Defined terms**

1. The seller or buyer, brokerage firm, and broker are defined and named once, and only once, in this section.
2. Every contract will have a different group of defined terms, and the licensee is expected to be able to define and fill them in for all approved forms.

## 3. Seller or buyer

- a. The full legal names of all recorded property owners or each buyer being represented are filled in.
- b. All persons listed \_\_\_\_\_ the contract.
- c. In the buyer listing, the term “buyer” expands to include any other person or entity that the named buyer may be representing.

## 4. Brokerage firm

- a. The listing contract belongs to \_\_\_\_\_ and not the individual broker completing the form.

## 5. Broker

- a. Brokers are the associates who will provide service to the client.
- b. Company policy will usually designate the associate completing the listing as the designated broker for this transaction.
- c. If a team is taking the listing, all team members are the “designated broker” and must be listed on the agreement. Only one of the team’s brokers must sign the agreement.

## 6. Property

- a. In the seller listing, what is being sold is defined and described, and the rights and interests (appurtenances) that the seller will convey are listed.
  - (1) Remember, a legal description describes the land only, but the sale includes all the improvements upon that land.
  - (2) In a buyer listing, the broker briefly describes the type of property that the buyer is seeking.
  - (3) It is used to define the basic type of property and a general location that the buyer is looking for.

## 7. Seller listing

- a. Affordable housing
  - (1) If the box is checked, the seller represents the property is part of an affordable housing program.
- b. Seller listing—sale of property
  - (1) Must be a \_\_\_\_\_ transfer (alienation) by the seller

## 8. Buyer listing—purchase or lease of the property

- a. Any transaction meeting the definition of a purchase \_\_\_\_\_ the buyer to pay the negotiated commission.
- b. The definition is quite broad and includes acquiring any interest, including leases or the right to acquire any interest.

9. Seller listing—listing period
  - a. This sets the beginning and end of the listing period.
  - b. The regulations require a \_\_\_\_\_ for termination of a listing (*CREM*).
10. Buyer listing—listing period
  - a. The buyer and broker agree to the specific dates that the contract will begin and end.
  - b. The broker agrees to assist the buyer through the completion of a transaction if the broker will be earning a success fee (commission).
  - c. In both contracts, this section makes it clear that completion of the assignment by the broker, by the closing, will satisfy the contract (executed).
11. Applicability of terms
  - a. Most of the blanks in a form are \_\_\_\_\_ items, and all of them must be addressed.
  - b. This section describes the effect of checking any box.

## **E. Brokerage relationship**

1. If the seller or buyer agency box or transaction-brokerage box is checked, it states how the broker will represent the seller or buyer based on the box checked on page 1 of the listing contract.
2. This section will allow the designated broker acting as an agent to move to the middle and represent both the seller and buyer if the appropriate box is checked. There is no need for the transaction-broker to move because the transaction-broker is already acting as a facilitator.
3. In-company transactions—different brokers
  - a. Designated brokerage eliminates a conflict of interest if different brokers within the same firm work with both the buyer and seller.
  - b. The brokers can each represent their party as an agent with no conflict to the other party.
4. In-company transactions—one broker
  - a. The broker has different responsibilities depending on whether the broker is representing a seller or buyer as an agent or transaction-broker.
  - b. Seller's or buyer's agent
    - (1) Through discussion and negotiation with the seller, one choice is made.
    - (2) Seller or buyer agency only
      - (a) This choice requires the broker to remain an agent for the seller or buyer and not enter into a brokerage relationship with any buyer or seller for this listing.
      - (b) The broker would disclose that the broker is the seller's agent and would have to treat the buyer as a customer, or the broker would disclose that the broker is the buyer's agent and the seller would be a customer if the broker double-ends the transaction.
      - (c) The broker would use the Brokerage Disclosure to Buyer form to make the buyer a customer. The Brokerage Disclosure to Seller (Sale by Owner) would be used to make the seller a customer.



- (3) Seller or buyer agency unless brokerage relationship with both
  - (a) This option is used when a broker is already working with a buyer and wants to show the broker's listing to that buyer. In this situation, the seller is agreeing to allow the broker to become a transaction-broker.
    - i) If the broker also has an agency listing with the buyer, the buyer must have also agreed to let the broker become a transaction-broker.
  - (b) This section also allows the broker to establish a new relationship with a buyer or seller and act as transaction-broker for both sides.
  - (c) Transaction-broker
    - (1) If the transaction-brokerage box is checked on page 1, the broker, if working with both the seller and buyer on the same property, must continue to act as a transaction-broker. The broker will not be an advocate or agent for either party.
    - (2) There is no conflict created, and the broker can represent both parties at the same time. There is no reason to notify anyone of a change of status because there hasn't been one.

## F. Brokerage duties

1. This section defines the uniform duties that the brokerage firm, acting through the designated broker, owes the seller or buyer in this contract.
2. Since this section outlines what is expected of the broker, it, in essence, creates the job description. Licensees should fully understand all the obligations they are agreeing to in this section.
3. The brokerage firm, acting through the broker, must provide uniform duties to the seller or buyer that apply to either the agent or transaction-broker relationship.
  - a. Failure to carry out these uniform duties is a \_\_\_\_\_ of the listing contract and could provide cause for cancellation of the listing.
  - b. The broker shall exercise reasonable skill and care for the seller or buyer, including the following:
    - (1) Perform all terms of the contract.
    - (2) Present all offers received before closing, even if the property is under contract.
      - (a) Seller listing: All offers must be presented to the seller, and multiple offers received by the broker must be presented to the seller \_\_\_\_\_ so the seller can decide which to accept or counter.
    - (3) Disclose to the buyer adverse \_\_\_\_\_ actually known by the broker.
      - (a) Facts are considered *material* if a party might decide differently once the facts are known.
    - (4) Advise the seller or buyer to seek expert advice on items beyond the broker's expertise.
      - (a) A broker potentially reduces the seller's or buyer's risk by recommending that the seller or buyer seek advice from experts on any matters beyond the scope of real estate brokerage.

- (5) Account for all money and property received.
- (6) Keep all parties fully \_\_\_\_\_ regarding all matters related to the transaction.
- c. The broker will not disclose, without \_\_\_\_\_, the following:
  - (1) The seller's or buyer's negotiation position regarding price, motivations, or financing options (remember PTM)
  - (2) Any personal information about the seller or buyer, unless the information has a material impact on the transaction
    - (a) The buyer's inability to get financing is a material fact that must be disclosed.
- d. Stigmatized property laws are created by each \_\_\_\_\_—not at the federal level.
  - (1) Stigmatized property may have a bad reputation because of events that happened there. These may be psychological defects, but they are not physical defects in the property.
  - (2) The fact that the property was the site of a homicide, other felony, or a suicide does not require disclosure.
  - (3) The law does not prohibit disclosure.
    - (a) A listing broker could disclose this information with the seller's written permission.
    - (b) A buyer's broker may disclose without permission.
  - (4) The Commission will not investigate a broker's failure to disclose stigmatizing information.
  - (5) AIDS and HIV are protected under federal fair housing law and may not be disclosed by either broker.
- e. Commission rules state that an associate broker may share confidential information with a supervising broker.
  - (1) The seller or buyer must give \_\_\_\_\_, which this section provides.
  - (2) The information may not be used to the detriment of the seller or buyer.
  - (3) This does **not** give the employing broker a brokerage relationship, which is between the designated broker and the party the broker has been designated to represent.
- f. A seller listing states that the broker and brokerage firm may have other listings, provided they do not present any conflict of interest with this listing.
- g. A buyer listing states that the broker may show the same property to other buyers without a conflict of interest.
  - (1) It would not benefit the broker to start a bidding war between the buyers.
- h. The broker is not obligated to seek additional offers to purchase once the broker has an accepted contract for sale, nor would the broker continue searching for other properties for the buyer.

4. There is no duty for the broker to investigate.
  - a. Colorado law specifically limits the broker's responsibility for investigating either the property or the parties to the transaction.
  - b. A broker who knows of a material defect is required to disclose it.
  - c. A broker who suspects a problem should strongly recommend specific professional investigation by an expert.
  - d. The broker has no obligation to \_\_\_\_\_ of the statements made by a party (unless the broker believes the party is lying).
5. A seller listing is a listing in which the seller can choose whether to allow the broker to disclose if there is already an offer on the property.
  - a. If allowed to disclose, the broker is also allowed to tell which firm made the offer. The broker is \_\_\_\_\_ the amount of any offers.

#### **G. Additional duties of seller's and buyer's agents**

1. This section adds three additional obligations of a seller's or buyer's agent, increasing the duties the agent owes to a seller and buyer over those owed by a transaction-broker (the difference between OLD CAR and DCAR).
2. If the agency box is checked, the broker is a limited (special) agent of the seller or buyer (principal) with the following additional duties:
  - a. Promote the principals' interest with the utmost good faith, loyalty, and fidelity
  - b. Seek price and terms as set forth in the listing contract
  - c. Counsel the principal about any material benefits or risks of a transaction based on the broker's professional knowledge and experience

#### **H. Compensation to brokerage firm; compensation to cooperative broker**

1. This section determines what the brokerage firm will receive as payment if it sells the property or assists a buyer in finding a property. It also establishes what the broker and brokerage firm must do to earn the commission and when it is due and payable.
2. Seller listing—compensation
  - a. Designated brokers (and all licensees) may receive compensation only from \_\_\_\_\_, not directly from the buyer or seller or another brokerage.
  - b. Amount
    - (1) Sale commission
      - (a) Commission amounts are set by each brokerage firm's office policy and negotiation.
    - (2) Lease and lease option commissions
      - (a) If the seller has agreed to pay a commission for a lease, specify how and when the commission is paid.

c. When earned

- (1) The brokerage firm earns a commission by getting a sale during the listing period or by finding a ready, willing, and able buyer even if the seller chooses not to sign the Contract to Buy and Sell or if the seller is unable or unwilling to close.

3. Buyer listing—compensation

- a. If the listing contract is for a purchase, the broker will check the appropriate compensation arrangements.
- b. The brokerage firm earns a success fee (commission) when the buyer finds a satisfactory property and buys it.

- (1) Amount

- (a) The fee is normally a percentage of the purchase price but could be a flat dollar amount.

- (2) Adjusted amount

- (a) If the broker is rebating or adjusting the commission, check this box and clarify the adjustment in additional provisions. If the fee will be calculated some other way or will not be money, write the terms of the payment carefully in the Other section.

- (3) Earned

- (a) If a transaction fails and the buyer is not at fault, the fee is waived.
  - (b) If the buyer's actions cause the transaction to fail, the success fee is payable immediately.

- c. Hourly fee—Some assignments may be very specific and require a lot of time (e.g., research) but ultimately end without a purchase by the buyer.

- (1) For an hourly fee, the licensee must document time just like any other professional paid hourly.

- d. Retainer fee—Some brokerage firms have a policy of collecting a retainer to assure that the buyer is serious.

- (1) These fees must have a standard policy that is uniformly applied to all similar situations to avoid any hint of discriminatory (disparate) treatment.

- e. Buyer listing—who will pay brokerage firms' fees

- (1) Listing brokerage firm or seller may pay. Buyer is obligated to pay.

- (a) Check this box if the broker will request payment from the listing broker or seller, but the buyer will be responsible for any amounts not covered by the listing broker or seller.

- (2) Buyer will pay.

- (a) Check this box if the buyer is obligated to pay the full commission.

- (3) Listing brokerage firm or seller may pay. Buyer is not obligated to pay.
- (a) Checking this option removes the buyer's obligation to pay the brokerage and requires the broker to receive full commission from the listing broker or seller.
  - (b) The buyer is then not obligated to pay any compensation. This may create issues for the obligation of the broker to find and show all properties to the buyer.
  - (c) The broker may want to list any limitations on what will be shown in additional provisions.
    - i) Example: The buyer agrees that the broker does not have any obligation to show any properties that the seller or listing broker does not agree to pay a co-op fee to the brokerage firm of at least X% of the sale price.
  - (d) If no box is checked, then the buyer shall not pay section will apply and the buyer is not responsible for the broker's commission.

4. Holdover period— \_\_\_\_\_

- a. The holdover period is a time period \_\_\_\_\_ between the parties.
- b. The broker must submit the potential buyers' names or properties shown in writing during the listing period.
- c. If the box "shall not owe" is checked, or an exclusive listing with another broker following expiration or termination of the listing (but within the holdover period) occurs, then the holdover provision will end. In this situation, the seller or buyer would not owe the broker a commission.

5. When applicable and payable

- a. Seller listing—Payment is due at closing or whenever the broker finds a ready, willing, and able buyer (during the term of the listing), and the seller defeats or declines to close the sale.
- b. Buyer listing—Payment is due at closing or whenever the broker finds a property that meets the buyer's criteria, and the buyer declines to close the sale.

6. Other compensation

- a. If the brokerage firm will receive any other form of compensation, describe it precisely.
- b. The Real Estate Commission has a position statement allowing a broker to " \_\_\_\_\_ " part of a commission to either the seller or the buyer as a \_\_\_\_\_ of the commission.

7. Seller listing—cooperative broker compensation

- a. The brokerage firm must seek assistance from and offer compensation to other brokerage firms.
- b. The seller listing determines the amount paid to a buyer's agent or transaction-broker working for the buyer.

**I. Limitation on third-party compensation**

1. This section requires that if the broker is to receive a referral or other similar payment from a source affiliated with the sale of the property (e.g., a lender or home warranty company), the broker must first get the seller's or buyer's \_\_\_\_\_.
2. The broker may not receive a fee from a \_\_\_\_\_ and must make sure any payments received are not in violation of the Real Estate Settlement Procedures Act (RESPA).

**J. Seller's and buyer's obligations to broker; disclosures and consent**

1. Seller listing contract (Seller's obligations to broker; disclosures and consent)
  - a. This section defines the duties the seller will owe the broker in this contract. It has four different obligations that the seller is agreeing to, as well as disclosure of the Colorado Foreclosure Act.
    - b. Obligation 1: Negotiations and communication
      - (1) This makes the seller's contract \_\_\_\_\_ with the brokerage firm.
      - (2) The seller agrees not to negotiate with others and to refer any communication about the property to the brokerage firm and broker. Other brokers may only communicate with the seller through the listing broker.
    - c. Obligation 2: Advertising
      - (1) The seller agrees not to advertise without the broker's approval.
    - d. Obligation 3: No existing listing contract
      - (1) The seller states if the seller has a listing contract on this property with any other broker.
    - e. Obligation 4: Ownership of material and consent
      - (1) The seller agrees that any materials given to the broker, including photographs, drawings, and so on, can be used by the brokerage firm, the broker, or on the MLS to market the property.
    - f. Colorado Foreclosure Protection Act
      - (1) The act applies if the property is residential, if the seller has been in default for more than 30 days or is in foreclosure, and if the property will be non-owner-occupied after closing. (This will be covered in more detail later.)
  - b. Obligation 1: Negotiations and communication
  - c. Obligation 2: Advertising
  - d. Obligation 3: No existing listing contract
  - e. Obligation 4: Ownership of material and consent
  - f. Colorado Foreclosure Protection Act
2. Buyer listing contract (buyer's obligations to broker)
  - a. This section defines the buyer's duties to the broker.
  - b. The buyer agrees to work "exclusively" through the broker.
    - (1) Brokers should make sure the buyer understands what this means.
  - c. The buyer represents that the buyer is not a party to another representation contract with another broker.

**K. Right of parties to cancel**

1. Terms and reasons the seller, buyer, or broker may cancel the listing are listed in this section.

**L. Disclosure of settlement service costs**

1. This section notifies the seller or buyer that the costs and quality of settlement services and providers (e.g., attorneys, lenders, inspectors, and title companies) will vary.

**M. Nondiscrimination**

1. All parties agree to follow federal, state, and local fair housing requirements. The seller or buyer is agreeing not to discriminate against any of the protected groups listed.
  - a. This section adds the state's protected classes of sexual orientation and marital status.

**N. Recommendation of legal and tax counsel**

1. As part of the *Conway-Bogue* decision, brokers are obligated to advise consumers that all contracts are important legal documents, and if the seller or buyer does not fully understand them, they should seek legal, tax, or other counsel.
2. This recommendation is the broker's legal duty.
3. The seller's or buyer's signature on the contract is acknowledgment that the broker fulfilled the obligation.

**O. Mediation**

1. All Commission-approved contracts require that the parties (seller or buyer and brokerage firm) agree to mediate before going to court to arbitrate or litigate a dispute they cannot resolve.
2. Mediation involves a neutral third party that helps the parties find a mutually agreeable solution.

**P. Attorney fees**

1. This section contains standard language used in all approved contracts.
2. If there is a lawsuit or arbitration, costs of the lawsuit and the winner's legal fees must be paid by the unsuccessful party.

**Q. Additional provisions**

1. The additional provisions section of all approved contracts must contain only those items that have been negotiated between the parties, which, in this case, are the seller or buyer and the brokerage firm. All other items should be in an addendum.

**R. Attachments**

1. Often, items are on separate pieces of paper that need to become part of the contract. Standard in all contracts is an attachments section that gives space to note all items to be attached and made part of the contract.
2. The items listed in the attachments section become part of the legal contract, such as the lead-based paint sales disclosure.

3. A lengthy legal description could be marked as “Exhibit A” and attached, rather than copying the long and complicated description.

#### **S. Notice, delivery, and choice of law**

1. This section, which is standard in all contracts, sets up how delivery of items in the contract will be handled—by either physical or electronic delivery or a combination of the two as indicated by the check box. It also states that the contract will be interpreted under Colorado law and not another state’s law.

#### **T. Modification of this listing contract**

1. Standard language in all contracts states that to modify (amend) the document, all modifications must be in writing and signed. Once the amendment is signed by all the parties, the contract has been modified and the modification is binding and enforceable.
2. The broker would use the Listing Contract Amend/Extend form to modify this contract.

#### **U. Counterparts**

1. This section, standard in all contracts, allows for separate signatures by the parties on different copies. Once all the copies are signed, they will be considered a complete contract.
2. If there are multiple sellers or buyers in different locations, this allows each seller or buyer to sign a separate, identical copy to form a complete contract.

#### **V. Entire agreement**

1. In all contracts, this section simply states that the entire agreement has been put in writing and is contained in the contract.
2. There is nothing that has been left out or is part of an unenforceable oral contract.

#### **W. Copy of contract**

1. Copying the contract keeps brokers in compliance with the Commission rule that requires brokers to give every party who signs a document a duplicate copy immediately. This can be accomplished in a variety of ways as outlined in the CREM.
2. All parties signing the listing must receive copies \_\_\_\_\_.
  - a. A married couple receives two copies, not one.
  - b. Photocopies, fax copies, or electronic copies can complete this requirement.
    - The CREM states: “A legible photocopy, carbon copy, facsimile, or electronic copies which contain a digital or electronic signature as defined in 24-71-101(1) C.R.S.”

#### **X. Contract signature section**

1. The broker will sign for the brokerage firm. (In a single-person firm, the individual broker will, of course, sign for herself.)
  - Application Note: A designated broker signs on the line next to the date and prints his name and address below, followed by the brokerage firm’s name and address.



### III. ITEMS SPECIFIC TO THE BUYER LISTING CONTRACT

#### A. Costs of services or products obtained from outside sources

1. This section defines who will be responsible for costs outside of the contract. The buyer and broker also agree that the broker will obtain the buyer's written permission before ordering or paying for services for the buyer, and the buyer is obligated to reimburse the firm.
2. This section protects both the buyer and the broker.

#### B. Brokerage services: showing premises (properties)

1. This section explains to the buyer any limitations the broker may have in regards to getting access to properties. This section also describes what access the broker has to properties.
2. Brokerage services
  - a. The broker and buyer can list additional brokerage services here.
3. Showing properties
  - a. Not all brokers have access to properties using electronic lock boxes or the MLS system.
    - (1) The broker should disclose any limitations to the buyer and discuss how the broker will arrange for access to these properties.
4. Refer to the Commission position statements in the CREM for further understanding of this section.

#### C. Disclosure of buyer's identity

1. If buyers, such as celebrities or high-profile businesspeople, do not want their names used during negotiations, they can check this box.
  - a. The brokerage firm's attorney would assist with creating a separate confidentiality contract to allow the firm to protect the buyer's identity.

#### D. Megan's Law

1. This section informs the buyer that if the buyer has any concerns about registered sex offenders, local law enforcement should be contacted. The CREM helps brokers define and work within the context of this federal law.

### IV. ITEMS SPECIFIC TO THE SELLER LISTING CONTRACT

#### A. Other brokers' assistance, multiple listing services, and marketing

1. The broker is informing the seller of the different methods available to market the property. The broker should fully understand and be able to describe the advantages, disadvantages, and any dangers or limitations created by the different methods. After discussion, the seller chooses the appropriate boxes.
2. MLS/information exchange
  - a. The seller may choose if the property is to be submitted to MLS and other property exchanges.

### 3. Property access

- a. The seller agrees to the form of access, manual or electronic lock box, or other methods.

### 4. Broker marketing

- a. The broker lists specific tasks to be performed by the broker to market the property.

## **B. Price and terms**

1. This section defines the listing price and any terms acceptable to the seller. Brokers should be aware of current trends and be able to advise the seller on all items.

### 2. Price

- a. This contains the seller's marketing price, which is usually the result of a competitive market analysis (CMA) provided by the broker and approved by the seller.

### 3. Terms

- a. The seller may agree to offer terms based on relevant market conditions.

### 4. Loan discount points and buyer's closing costs (FHA/VA)

- a. The amount a seller is willing to give in concessions, such as paying for the buyer's points or closing costs, are listed here.

### 5. Earnest money

- a. Earnest money is the seller's \_\_\_\_\_ when the seller takes the property off the market while the buyer seeks financing and prepares for closing.

(1) Often in the form of cash, personal check, or earnest money promissory note

(2) Can be anything the seller will accept, such as personal property

### 6. Seller proceeds

- a. The seller has an opportunity to specify how the seller wants to receive the \_\_\_\_\_ at closing.

### 7. Advisory—tax withholding

- a. In Colorado, closing companies may be required to withhold for potential Colorado \_\_\_\_\_ if a seller lives out of state.

## **C. Deposits**

1. This section authorizes the brokerage firm to accept and hold earnest money deposits for the seller, which must be held in an escrow or trust account of either the listing brokerage firm or a title company.

2. An employing broker must deposit the earnest money into a proper account no later than the third business day following notice of acceptance of the offer.

#### D. Inclusions and exclusions

1. This section defines what is to be included in the sale of the property.
  - a. The seller and buyer typically do not understand the difference between a fixture (attached items conveyed in the deed) and personal property, which may be a part of the sale but will be conveyed by a bill of sale.
2. The broker, in a walk-through before listing, should ask the seller if items such as ceiling fans or draperies will be included.
3. Inclusions—the purchase price includes the following:
  - a. Fixtures
    - (1) Lists items that will be included in the sale, if they are attached at the date of this listing contract, or if they are not specifically \_\_\_\_\_ the exclusions subsection.
  - b. Personal property
    - (1) These items are not considered fixtures, but often might be included if they exist.
    - (2) The items in bold print preceded by boxes (e.g., water softeners) may look like fixtures, but could be leased by the seller rather than owned.
      - (a) The listing broker should research the terms of such a lease for use at the time of sale.
    - (3) The blank after the last box provides additional space to add personal property items the seller wishes to include in the sale, such as appliances or yard maintenance tools.
    - (4) Personal property will be transferred free and clear of encumbrances.
    - (5) A \_\_\_\_\_ conveys personal property.
  - c. Trade fixtures
    - (1) Any trade fixtures to be conveyed are listed here and conveyed by a bill of sale.
  - d. Parking and storage facilities
    - (1) A condominium or other common interest community property may include parking or storage facilities not physically connected to the unit.
    - (2) Check if the parking is for use or ownership, and note the storage facilities that will be conveyed with the property.
  - e. Water rights
    - (1) If the sale will include water rights, the legal description of those rights belongs here.
  - f. Growing crops
    - (1) Any crops (emblems) to be conveyed are listed here.
4. Exclusions
  - a. List any items (e.g., fixtures or personal property) that the seller does not want to sell with the real property.

**E. Title and encumbrances**

1. The seller(s) is(are) agreeing to the following:
  - a. The property is in seller's name. (There are no other owners.)
  - b. The sellers will provide any information and documents they have to the broker.
  - c. The seller will transfer (convey, alienate) with the type of conveyance deed listed in this section.
    - (1) A residential property will be conveyed by the type of deed chosen by the check box (special warranty, general warranty, or another deed selected).
  - d. The seller agrees to pay any taxes except the taxes that will be due for the year of closing. (Those will be prorated between the seller and buyer at closing.)
  - e. The seller agrees to pay off all monetary encumbrances unless the buyer specifically agrees to assume them.
  - f. Special improvement liens must be paid off \_\_\_\_\_ unless the buyer agrees to \_\_\_\_\_ the obligation.
  - g. The broker should list the known encumbrances, even if they will be paid off. This section will give the broker permission to get current loan information regarding lien amounts and the balance owed.
  - h. If there are any leases or tenancies, a buyer would take title subject to those leases.

**F. Evidence of title**

1. The \_\_\_\_\_ agrees to furnish and pay for the buyer's title insurance policy. If the seller prefers to use an abstract (not typical in Colorado), that box would be checked.
2. The policy is paid for at closing. (It will be a debit to the seller.) The policy will be delivered at closing or shortly after the property closes.

**G. Association assessments**

1. If the property is in a common interest community with mandatory assessment power, the seller should supply the broker with the information to
  - a. list the amount and frequency of regular assessments,
  - b. state the current status of payments, and
  - c. list any special assessments that are outstanding.
2. The seller agrees to get a statement from the association verifying the status of assessments.

**H. Possession**

1. This section indicates how and when the seller will deliver possession of the property.

## I. Material defects, disclosures, and inspection

1. This section explains material facts to the seller and informs the seller of the broker's obligation to disclose any known material facts to potential buyers.
2. Broker's obligations
  - a. This section informs the seller that the broker is obligated to disclose \_\_\_\_\_ to any prospective buyer.
  - b. The seller agrees that any buyer may have various inspections performed.
3. Seller's obligations
  - a. Seller's Property Disclosure form
    - (1) This approved form is not required by state law as a part of the real estate transaction.
    - (2) The Contract to Buy and Sell Real Estate requires the form, unless the seller removes the requirement in a counteroffer.
    - (3) Disclosure of known adverse material facts is required by law.
    - (4) The broker should inform the seller that the \_\_\_\_\_ will most likely expect to have the form.
    - (5) If sellers want to sell "as is," then they
      - (a) must still disclose material defects both obvious and latent, and
      - (b) are stating that they will not repair any defects either disclosed or identified by a buyer's inspection.
    - (6) If the broker suspects that the sellers are trying to hide a material fact, the broker should confront them and be prepared to resign or not take the listing if they refuse to disclose.
      - (a) Example: After heavy rains, the seller's basement occasionally floods. In the ten years the seller has owned the home, it has flooded three times. This would be considered a material latent defect that the seller needs to disclose. If the seller does not disclose the defect and the buyer discovers the defect after the sale, the buyer could sue the seller to cure (fix) the defect.
  - b. Lead-based paint
    - (1) Federal law requires that the \_\_\_\_\_ for disclosing possible, potential, or known lead-based paint hazards or any other known lead hazards.
      - (a) Applies to residential dwellings with a \_\_\_\_\_ prior to January 1, 1978
    - (2) Commission rules provide the following:
      - (a) An approved form is provided for the seller's use.
      - (b) The lead-based paint disclosure needs to be provided by the date in the dates and deadlines section of the contract.

c. Carbon monoxide alarms

- (1) This section notifies the seller of the obligation to ensure that there are operational carbon monoxide alarms installed within 15 feet of all bedrooms, or in locations per building codes, prior to the sale or lease of the property.
- (2) This rule applies to all properties with fuel-fired heaters or appliances, a fireplace, or an attached garage. There must be an operational carbon monoxide alarm installed within 15 feet of the entrance to each bedroom or in a location required per building codes.

**J. Forfeiture of payments**

1. In the event of a forfeiture of payments made by a buyer, the sums received shall be 100% paid to the seller or divided between the brokerage firm and seller.
  - a. The broker will not get more than the agreed-upon commission.
  - b. This money doesn't reduce any commission earned from another sale that closes.
  - c. If no box is checked, 100% is paid to the seller.

**K. Cost of services and reimbursement**

1. The parties will not order or expect the other to pay for anything that would be their own obligation.
  - a. The brokerage firm will not order anything the seller would be responsible to pay for without written permission from the seller.
  - b. The seller will not order anything the brokerage firm would be responsible to pay for without permission from the brokerage firm.

**L. Maintenance of the property**

1. This section reminds sellers that they are still responsible for maintaining the property during the listing period.
2. It explains the brokerage firm and broker will not be held liable for any damages unless the damage is caused by the negligence or intentional misconduct of the broker or brokerage firm.

**M. No other party or intended beneficiaries**

1. This section states clearly that obligations and benefits of the contract are between the seller, broker, and brokerage firm and do not apply to any other persons.

**V. OTHER ISSUES WHEN WORKING WITH THE SELLER**

**A. Sign crossing**

1. Any broker who obtains an Exclusive Right-to-Sell Listing Contract is protected from other brokers trying to take the listing during the listing period.
2. Brokers must not "cross the sign" of another broker. This means that they may not approach the seller for any reason while the property is listed (i.e., has a sign in the yard).

- a. All \_\_\_\_\_ must be handled through the listing broker.
  - (1) The only exception is when the \_\_\_\_\_ approaches a broker who is not the listing broker. This broker may negotiate and sign a new listing with the seller as long as the new contract beginning date is after the \_\_\_\_\_.

## **B. Single-party listings**

- 1. This rule protects for sale by owners when they agree to pay a commission to a broker for bringing a buyer.
- 2. There might be occasions where a broker may wish to list a property with the seller for only one buyer as a means of protecting the broker's commission.
  - a. Example: A designated broker working under an Exclusive Right-to-Buy Listing Contract has a buyer who wishes to buy an FSBO property. (The seller is selling the property himself without using a brokerage firm.) The broker has approached the seller, and he has agreed to pay the broker's commission if this buyer purchases the property. The broker might have the seller sign a single-party listing specifying that if this buyer purchases the property, the agreed-upon commission will be paid. This prevents the seller from secretly selling to the buyer without the broker.
  - b. To protect the seller, when using the Exclusive Right-to-Sell Listing Contract, the broker should add the following to the additional provisions section:
    - (1) The provisions of this listing contract shall apply only in the event a sale is made to: (buyer's name).
    - (2) The termination date shall not be extended by the \_\_\_\_\_ of this listing contract.
    - (3) In the event a sale is made by the owner or the owner's broker to any party other than the above-named, this listing contract is void.

# UNIT 2 REVIEW EXAM

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*This is a non-graded exam review. You should look up any questions you miss.*

1. In Colorado, real estate compensation is established by
  - A. law.
  - B. the Real Estate Commission.
  - C. local groups of brokers.
  - D. each brokerage firm.
2. The listing broker brings the seller a customer's offer that meets all the requirements of the listing, but the seller decides not to sell. This means that the
  - A. broker can sue the seller for specific performance.
  - B. broker has earned the commission.
  - C. buyer can sue the seller for specific performance.
  - D. seller has the right to discharge the listing with no penalty because it is just an employment agreement.
3. In Colorado, a consumer can become a customer
  - A. by default, if the person has not signed a contract.
  - B. by signing a written disclosure.
  - C. by the principal requiring that the broker remains a transaction-broker and treats the other party as a customer.
  - D. automatically upon attending an open house where the listing broker is an agent for the seller.
4. All of the following are essential elements of a deed *EXCEPT*
  - A. competent grantor.
  - B. competent grantee.
  - C. in writing.
  - D. legal description.
5. Five years ago, Unit 5B in a condominium community was the site of a brutal and highly publicized murder. An elderly woman bought the unit. She later contracted the AIDS virus from a blood transfusion and died in the unit. The listing broker for the woman's estate has which disclosure responsibilities to prospective purchasers of Unit 5B?
  - A. The listing agent must disclose both the murder and the AIDS-related death.
  - B. Both brokers are prohibited by law from disclosing either event.
  - C. The listing broker under Colorado stigmatized disclosure law is not required to disclose either event.
  - D. The listing broker does not need to disclose the murder but must disclose the AIDS-related death.
6. Commission rules require that a listing broker who is going to discuss confidential information with a buyer do all of the following *EXCEPT*
  - A. disclose the broker's relationship orally before accepting any information about motivation.
  - B. have the buyer sign the Brokerage Disclosure to Buyer form.
  - C. disclose before accepting any confidential information.
  - D. give the written disclosure at first physical contact.
7. Legal title to real estate is conveyed by a
  - A. bill of sale.
  - B. conveyance deed.
  - C. deed of trust.
  - D. Contract to Buy and Sell Real Estate.
8. Every listing must have
  - A. a list of all confidential items.
  - B. a description of all exclusions.
  - C. an attached Seller's Property Disclosure.
  - D. a definite termination date.



9. Based on the exclusive right-to-sell contract, the listing broker must disclose to any potential buyer
  - A. facts about the seller actually known by the broker.
  - B. material facts about the property actually known by the broker.
  - C. all facts about the transaction actually known by the broker.
  - D. the motivations of the seller, if requested by the buyer.
10. According to the exclusive right-to-sell contract, fixtures listed on the approved form will be included
  - A. unless they are crossed out on the form.
  - B. if they are on the property at the time of the purchase.
  - C. if they are attached as of the date of the listing unless specifically excluded by the seller.
  - D. in every case.
11. A single agent representing a principal could do which of the following for an unrepresented customer?
  - A. Nothing, except have the customer sign a Definitions of Working Relationships disclosure
  - B. Complete the Contract to Buy and Sell Real Estate but not explain it
  - C. Disclose both benefits and risks of the transaction
  - D. Anything that does not compromise the agency relationship
12. Legal descriptions describe the
  - A. property and all appurtenances.
  - B. land.
  - C. land and all improvements.
  - D. property and rights conveyed.
13. The employing broker has designated a broker associate to represent a seller. Who is the brokerage relationship between?
  - A. The designated broker and seller, unless the employing broker has to supervise, which would add the employing broker to the relationship
  - B. Only the designated broker and the seller
  - C. The seller, employing broker who owns the contract, and designated broker
  - D. The seller, designated broker who owns the contract, and the other brokers in the company
14. The exclusive right-to-sell contract provides choices for an agent-broker to handle an in-company transaction. Which of the following is *TRUE*?
  - A. The seller only determines which of the two choices applies to the listing.
  - B. The broker determines which of the two choices applies to the listing.
  - C. Colorado law requires an addendum chosen by the seller.
  - D. The seller and broker negotiate the most appropriate choice based on company policy and the seller's desires.
15. An agent owes the seller or buyer all of the following *EXCEPT*
  - A. consideration.
  - B. reasonable skill.
  - C. accounting.
  - D. loyalty.
16. Based on the language of the Exclusive Right-to-Sell Listing Contract, if a defaulting buyer forfeits an earnest money deposit, the
  - A. checked box in the contract would determine how the earnest money would be disbursed.
  - B. broker would receive the funds.
  - C. seller may keep the funds.
  - D. broker and seller would submit the funds for mediation.
17. A buyer asks to see a broker's agency listing. The broker must
  - A. seek the seller's permission to show the property.
  - B. have an exclusive agency relationship with the buyer.
  - C. disclose to the buyer the broker's relationship with the seller.
  - D. provide a Seller's Property Disclosure.
18. The contract that provides maximum protection for the brokerage firm is the
  - A. first right of refusal.
  - B. open listing.
  - C. exclusive agency.
  - D. exclusive right to sell.

19. An exclusive agency listing
  - A. allows only the agent bringing the buyer to get paid.
  - B. pays the listing broker only if the listing broker procures the buyer.
  - C. allows the seller to sell without paying a commission.
  - D. must be signed by the buyer's agent.
20. Addenda that are not negotiated between the parties may be drafted by all of the following *EXCEPT*
  - A. a party to the transaction.
  - B. the brokers representing the parties.
  - C. an attorney for one of the parties.
  - D. an attorney for the brokerage firm.
21. The Brokerage Disclosure to Buyer form is used for all of the following *EXCEPT*
  - A. giving notice to a customer.
  - B. meeting the default requirement for disclosure, if the broker is a transaction-broker.
  - C. keeping brokers in compliance with Commission rules.
  - D. establishing a brokerage relationship as an agent.
22. The listing broker has done a visual inspection of the property and found no issues. The Seller's Property Disclosure shows no material defects. When is the broker *NOT* responsible for the seller's misrepresentation of the property?
  - A. The broker will always be responsible for disclosing all defects.
  - B. When the broker learns of a defect after the listing is signed
  - C. If the material defect is latent and the broker has no way of knowing it
  - D. Brokers are never liable for a seller's actions.
23. According to the exclusive right-to-sell contract, the designated broker is responsible for all of the following *EXCEPT*
  - A. disclosing latent material defects listed by the seller.
  - B. advising the seller to seek outside advice on material matters beyond the broker's expertise.
  - C. following the seller's instructions for showing the property.
  - D. verifying the accuracy or completeness of the seller's statements.
24. To modify an executory contract, a broker uses which form?
  - A. Addendum
  - B. Attachment
  - C. Agreement
  - D. Amendment
25. Rights and benefits that transfer with land are
  - A. accretion.
  - B. emblements.
  - C. appurtenances.
  - D. encumbrances.

# ANSWER KEY AND RATIONALES FOR UNIT 2

## REVIEW EXAM

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1. **D** The answer is each brokerage firm. Broker's fees are determined by each brokerage firm. If groups of brokers agreed on a standard commission, they would violate the federal Sherman Antitrust Act.
2. **B** The answer is broker has earned the commission. The wording in the listing contract states that the contract is irrevocable. The seller may not unilaterally remove the obligation to pay a commission for a sale during the term of the listing. The seller can remove the broker's authority to market the property. Even though the seller did not accept the offer, the broker has met the requirements of the listing contract and is due a commission.
3. **B** The answer is by signing a written disclosure. *Customer* is the term for an unrepresented party who has not hired a broker. The broker is obligated to disclose this status in writing; it is not automatic. The disclosure form has a place for the buyer to acknowledge receipt of the form. If the buyer declines to sign, the disclosure is still effective and the buyer will be an unrepresented customer.
4. **B** The answer is competent grantee. A deed does not require a competent grantee. Property can be conveyed to a minor. The other elements are required for a valid deed.
5. **C** The answer is the listing broker under Colorado stigmatized disclosure law is not required to disclose either event. The stigmatized property law states that psychological stigma are not material facts and do not require disclosure by the listing broker. The buyer's broker may not disclose AIDS/HIV but could disclose the murder without the seller's permission.
6. **B** The answer is have the buyer sign the Brokerage Disclosure to Buyer form. The purpose of the disclosure requirement is to warn people not to give confidential information to the other party unless that party agrees to it. Thus, the real timing issue is to ensure disclosure prior to the receipt of confidential information. The broker is required to give the written disclosure, and if the member of the public refuses to sign it, the broker simply makes note of the name and date on the broker copy (which is filed). There is no requirement for signatures.
7. **B** The answer is conveyance deed. Basic concept review: A deed conveys real property. *Conveyance* is an adjective describing the function and not a legal type of deed, such as a general warranty deed.
8. **D** The answer is a definite termination date. Commission rules require a definite termination date on all listings.
9. **B** The answer is material facts about the property actually known by the broker. Brokers always have an obligation to disclose known material facts to all parties.
10. **C** The answer is if they are attached as of the date of the listing unless specifically excluded by the seller. Fixtures are automatically included if attached at the time of the listing, but they may be specifically excluded by the seller. This answer is more complete than B, which addresses the sales contract.
11. **D** The answer is anything that does not compromise the agency relationship. A broker is allowed to do anything for a customer that does not compromise the agency relationship the broker has with the other party.

12. **B** The answer is land. The legal description is the land. All the improvements and fixtures are included in any conveyance of the land.
13. **B** The answer is only the designated broker and the seller. The brokerage relationship is only between the designated broker and the person represented. The employing broker has no brokerage relationship even if the employing broker learns confidential information as part of supervisory duties.
14. **D** The answer is the seller and broker negotiate the most appropriate choice based on company policy and the seller's desires. The brokerage relationship is created through negotiation based on what the broker's office policy allows. Resolution for the potential conflict of interest is negotiated between the seller and the broker but must be consistent with company policy.
15. **A** The answer is consideration. Basic concept review: These are fiduciary duties (OLD CAR). Consideration is required to form a contract but is not the "C" in OLD CAR; the "C" is confidentiality.
16. **A** The answer is checked box in the contract would determine how the earnest money would be disbursed. The Exclusive Right-to-Sell Listing Contract provides this right to the broker.
17. **C** The answer is disclose to the buyer the broker's relationship with the seller. Commission rules require disclosure before eliciting or receiving confidential information.
18. **D** The answer is exclusive right to sell. Basic concept review: The Exclusive-Right-to-Sell Listing Contract provides a commission to the broker if the property sells during the listing period. The other arrangements are less secure.
19. **C** The answer is allows the seller to sell without paying a commission. Basic concept review: An exclusive agency listing allows the seller to sell without paying a commission.
20. **B** The answer is the brokers representing the parties. Brokers may not draft an addendum that was not negotiated between the seller and the buyer to the Contract to Buy and Sell Real Estate.
21. **D** The answer is establishing a brokerage relationship as an agent. An exclusive right-to-sell or right-to-buy listing contract must be used to create an agency relationship. The Brokerage Disclosure to Buyer does not meet the requirement that agency contracts be in writing. The disclosure form does meet the disclosure requirements for customers and default transaction-brokers, and it is used to keep brokers in compliance.
22. **C** The answer is if the material defect is latent and the broker has no way of knowing it. Real estate licensees are not responsible for inspecting and finding latent (hidden) defects. If the broker did a visual inspection and the seller stated that there were no problems, the seller would be guilty of fraud.
23. **D** The answer is verifying the accuracy or completeness of the seller's statements. The listing contract states that the broker has no duty to conduct an independent inspection or to verify the completeness and accuracy of statements made by the seller.
24. **D** The answer is amendment. With an amendment, both parties agree to change (amend) an existing executory contract.
25. **C** The answer is appurtenances. Basic concept review: Rights and benefits that run (transfer) with the land are appurtenances. Accretion is not a right or a benefit, encumbrances are limitations on the rights transferred, and emblements are growing crops and personal property.

# UNIT 3

## Colorado Contract to Buy and Sell Real Estate

### OVERVIEW OF CONTRACTS

Real estate professionals are involved in contracts in various ways. A typical broker has an independent contractor's agreement and often an employment/commission contract with the brokerage firm. On a daily basis, brokers should work to establish a working relationship representing a seller, buyer, landlord, or tenant, and these representation roles are created through contracts. Brokers will assist the party or parties they represent in negotiating a variety of contracts, such as options, purchase contracts, and leases. It is imperative that all licensees understand the requirements of valid contracts and what makes them void or voidable. Real estate professionals must also know the rules and requirements of these documents, which typically come from common law or state law.

### Basic Contract Law

There are some basic assumptions that can be made about contract formation, and one is that all parties who sign the document have read and understood it. The presumption is that if the document was not understood, the party would not sign it. The types of people that brokers deal with varies for each transaction, and some parties are very careful, ask numerous questions, and do not move on until everything is clear to them. This conservative type also tends to have an attorney review documents prior to signing. At the other extreme are those who believe that the real estate professional is knowledgeable and looking out for their best interest, so they trust that the broker is taking care of them and sign without reading the documents. An important part of a real estate professional's job is making sure that everyone signing the documents has a full understanding of them, including the obligations a signature creates. All parties should be advised to seek legal, tax, or other counsel prior to signing.

All real estate professionals should be able to clearly explain all documents that they present to parties they represent. Brokers must never give legal or tax advice about documents, but should make sure that all parties signing fully understand the repercussions of a signature.

Under the common laws of contracts that were previously covered, we learned that the essential elements of valid contracts are competent parties, offer and acceptance (a meeting of the minds), consideration, and a lawful purpose. For contracts involving the transfer of real property rights, the statute of frauds requires that the contract be in writing (the fifth essential element), with the exception of certain shorter-term leases. If the contract has all of these elements, it is considered valid and enforceable in court. If the contract lacks one of these elements, it is void and does not exist in the eyes of the law. Contracts entered into by minors and parties under the temporary influence of drugs or alcohol, or under duress, fraud, or misrepresentation, are voidable by the minor or the party who has been put at the disadvantage. For example, Jane enters into a contract to buy a property based on the fraudulent claims made by Sal. The contract will be voidable by Jane who can proceed to closing or rescind the contract, depending on her wishes. Sal would have no recourse since he was the perpetrator of the fraud.

The essential element of competent parties requires that all parties to the contract meet the condition of competency, which requires them to be sane, sober, and of legal age (18 years old). (A valid deed requires only the grantor or grantors to be competent. In contracts, both parties must be competent.) If these criteria are met, the first requirement of a valid contract has been established. If a party is not competent, the contract can be void or voidable, depending on whether the mental competency is considered permanent or temporary. For example, if a person adjudicated as incompetent by a court signs a contract, the contract is automatically void. A contract signed by an inebriated party is voidable by that party once the party has regained a state of sobriety. Minors signing or entering into a contract will always make the contract voidable. Under law, minors have limited contractual abilities. For example, minors can enter into an employment contract, but they cannot buy, sell, or lease property and, if allowed to do so by an adult, the document the minor signs will be voidable by the minor. It is incumbent upon the adult to verify that the party signing the document is not a minor. Minors who have entered into contracts may rescind the contract at any time; however, the minor must reach the age of majority to affirm a contract. The minor is given a reasonable period after reaching majority to either disaffirm or affirm a contract. For example, a minor legally inherits a property at age 17 and then enters into a contract to sell the property to an adult. The contract and sale would be voidable by the minor. If, after turning 18, the minor realizes it was a mistake to sell the property, the minor could take action to rescind the sale.

Offer and acceptance is the period during which the negotiations on contract terms are being completed. This can be confusing because often the purchase contract is called a contract; however, it is an offer until both parties reach a meeting of the minds and communication of acceptance has been made. Brokers should correctly refer to this document by using statements such as: "I am helping the buyer write an offer (on the contract form)"; "We are negotiating an offer"; "Congratulations, your offer has been accepted and we are under contract"; and "I am working to get the contract to closing." Typically, in this stage, the buyer makes an offer and the seller may either accept the offer or make a counteroffer, which is a termination/rejection of the original offer. The back-and-forth negotiation process is continued until there either is a meeting of the minds or the offer fails.

The final step in moving from an offer to contract is the offeree's communication of acceptance to the offeror. The offeror may either be the buyer or the seller, depending on which party extended the last offer. (If the seller makes a counter, the seller becomes the offeror and the buyer the offeree.) Once communication of acceptance is completed, the offer becomes an executory contract. Often, the listing and/or purchase contract will contain a provision stating that once the broker who represents the party has received notice of acceptance, that party is considered to have received notice and the offer moves to contract.



For example, Kim is the designated buyer's broker and Joe, who works for the same firm, is the designated seller's broker. Offers and counteroffers have been made over a period of days, and Joe just called Kim to tell her that the seller accepted the most recent offer. With this notice, the property is under contract even though the buyer has yet to be personally notified. Kim's next step should be to call and notify the buyer. It is critical that licensees understand the concept of notice because all parties have the right to terminate an offer any time prior to receipt of the acceptance notification when the offer becomes a contract. Oral notification of acceptance is acceptable if all parties have actually signed the offer, and it should be followed by timely receipt of the signed contract by all parties.

Consideration is something of value used to entice one party to enter into a contract. Consideration can be promises of specified actions, money, or anything of value. In a purchase contract, it is typically the mutual promise of the buyer to buy and the seller to sell. Consideration is critical because it is used to differentiate a contract from a gift. For example, Bill tells Michele that he will give her a car. Michele accepts Bill's offer, but later, Bill decides not to give Michele the car. Michele would have no recourse against Bill because she gave no consideration in exchange for the car; it was a gift. On the other hand, Michele asks Bill if he will sell her his car. Bill agrees—if Michele will pay him \$1,000. Michele and Bill write a contract stating the terms with Michele agreeing to pay in full the next week. The promise of Michele to buy at a specified price and Bill to sell has created the consideration for the contract. Earnest money is not consideration and is not required to create a valid contract. If used, earnest money is deemed a liquidated damage that the seller will receive if the buyer defaults.

Lawful objective is a requirement that all contracts be for legal purposes. If the contract does not meet this requirement, it is void. The absurdity of asking a court to uphold a contract for illegal purposes is obvious.

The statute of frauds requires that contracts for the transfer of any interest in real estate be in writing with the exception of certain leases. For example, Ned and his neighbor Rose verbally agree that Ned will buy Rose's property. Two weeks later, Ned discovers that Rose has sold her property to another party. Ned does not have recourse because a verbal contract is not enforceable. Some states allow representation or employment contracts to be verbal, but the commission agreement is not enforceable in court. In real estate, the best practice is to put everything in writing, especially contracts.

## Purchase Contracts

Because the purchase contract is a document between the buyer and the seller, it is inappropriate to include any items that apply to the brokerage firm. For example, do not list the brokerage commission amount within a purchase contract. This should be in either the agency contract or a separate commission agreement.

A typical purchase contract has a heading, a body, and a signature area. The heading defines and names the type of agreement, sets up the promises of each party, usually defines who the parties are, and describes the property using the street address, if appropriate, and the legal description. The body further establishes the obligations of the parties, including what is included or excluded from the sale, the terms and conditions, and any contingencies for due diligence, inspections, appraisal, or financing. The final segment is the signature area where the parties sign. Typically, real estate professionals help buyers complete offers by filling in blank spaces in approved forms, but they are not allowed to draft contract language for others. Colorado uses forms created and approved by the Real Estate Commission. An attorney may also draft contracts for either party.

In the process of helping to write or present an offer, real estate professionals should be able to fully explain what each section of the contract means and its impact on the party. For example, a seller asks what would happen if he decides he does not want to sell after the purchase contract has been signed, so the agent helps him review the section of the purchase contract that addresses a breach by the seller. Another example is a buyer who requests that the seller leave the refrigerator. After reviewing the inclusions section, the buyer does not see the refrigerator listed, so she asks the broker if it has been included elsewhere. The broker realizes his mistake and adds the refrigerator to the inclusions section. If this fix had not been made, the buyer might have requested that the broker pay for a new refrigerator because it was his mistake for not completing the form as requested. Reviewing the forms with buyers and sellers every time will help avoid these types of errors. Additionally, because the offer and contract are binding legal documents, all parties should fully understand the obligations they are assuming. Any broker who feels that a party does not understand these obligations should recommend that the party seek legal advice. Most states require the broker to recommend that the parties consult legal, tax, or other counsel prior to signing documents.

## COLORADO CONTRACT TO BUY AND SELL REAL ESTATE

- The Real Estate Commission has approved five forms for the Contract to Buy and Sell Real Estate. The forms are the following:
  1. Residential—used for all non-income residential sales
  2. Income-residential—used for all residential income sales
    - Broker will note if the property is one to four units or larger. This difference has an impact on loans the buyer may obtain. This form is used for the sale of any residential income property.
  3. Colorado Residential Foreclosure Act—used if the Colorado Foreclosure Protection Act applies
    - The act applies if the property is residential, the seller is in default for more than 30 days or in foreclosure, and the property will be non-owner-occupied. This form meets the requirements of the act.
  4. Commercial—used for all commercial property sales
    - This contract cannot be used for any type of residential property.
  5. Land—used for vacant land sales
    - If residential property is to be conveyed, this contract requires a residential addendum.
- The contract contains eight segments: (1) heading; (2) agreement; (3) transaction provisions; (4) disclosure, inspection, and due diligence; (5) closing provisions; (6) general provisions; (7) additional provisions and attachments; and (8) signatures.
  - The agreement segment defines the parties, property, and what is being agreed to in the contract. In this case, the buyer is agreeing to buy and the seller is agreeing to sell. Any exclusion of fixtures and inclusions of personal property are listed. Water or well rights, if any, are described, and what is being conveyed and how it is are determined. The dates and deadlines for all contingencies in the contract are listed in one chart in this section, which allows the reader to easily find all dates. The purchase price and how it is to be paid (e.g. cash, loan, and so on) are the last items in this section.
  - The transaction provisions segment further defines the loan terms and contingencies, such as an appraisal. Title issues are also described and who is responsible for payments is determined.



- In the disclosure, inspection, and due diligence segment, the Seller's Property Disclosure is requested and the buyer's right to a property inspection is established. The buyer is given the opportunity to request documents, such as leases, and the right to object to any of the documents. Time frames are set in the dates and deadlines table. Per the inspection contingency, the buyer may terminate the contract for any reason prior to the inspection objection deadline. If the buyer is making a request of the seller, the buyer and the seller will have until the inspection resolution deadline to negotiate the terms of request, and if no resolution is found, the contract will terminate at midnight on the inspection objection deadline. The buyer is given notice of other items such as source of water for the property, carbon monoxide alarms, lead paint, and methamphetamine labs.
- The closing provisions segment is used to determine the closing and possession dates as well as the closing instructions, transfer of title, and how items will be prorated between the buyer and the seller.
- The general provisions segment defines how any damage or loss of the property during the executory phase will be handled. The choices are to make the contract default, pay liquidated damages, or use specific performance. Along with creating the agreement to mediate, this segment determines who will pay legal fees if the contract goes to litigation and how notice and delivery of documents will be given. Finally, this segment reminds the parties to work in good faith to complete the transaction.
- The last two segments of additional provisions and attachments and signatures advise on what is being added to the contract either in additional provisions or as an attachment, and the parties are given a place to sign the document.

## UNIT 3 LECTURE OUTLINE

### I. UNDERSTANDING THE CONTRACT TO BUY AND SELL REAL ESTATE

#### A. The Real Estate Commission has approved six forms of the Contract to Buy and Sell Real Estate.

1. Residential—used for all non-income residential sales
2. Income-Residential—used for all residential income sales
  - a. The broker will note if the property is one to four units or larger. This difference has an impact on loans the buyer may obtain for the sale of any residential income property.
3. Colorado Residential Foreclosure Act—used if the Colorado Foreclosure Protection Act applies
  - a. The act applies if the property is residential, the seller is in default for more than 30 days, or the property is in foreclosure and will be non-owner-occupied. This form meets the requirements of the act.
4. Commercial—used for all commercial property sales (cannot be used for any type of residential property)
5. Land—used for vacant land sales
  - a. If residential property is to be conveyed with the land, this contract requires a residential addendum.
6. Manufactured home—used for manufactured homes sold on leased lots

#### B. Note

1. Unless stated, all references to the Contract to Buy and Sell Real Estate in Units 3 and 4 are to the residential version.

### II. CONTRACT TO BUY AND SELL REAL ESTATE

#### A. The Contract to Buy and Sell Real Estate is divided into eight segments.

1. Heading—establishes the form's name and date and gives the Commission-required disclaimer and form number
2. Agreement—defines the terms \_\_\_\_\_ and the dates and deadlines for the contract
3. Transaction provisions—used to define financing, title work, and termination terms
4. Disclosure, inspection, and due diligence—defines the rights and obligations of each party
5. Closing provisions—sets up all terms and items needed for closing the property
6. General provisions—defines standard items, such as default options and earnest money
7. Additional provisions and attachments—used for property-specific items and documents that are attached to the offer
8. Signatures—used for signatures of the parties and broker acknowledgments

**B. Heading**

1. This section gives the required notice of “legal consequences,” the form number, and the date, which is often mandatory.
2. Brokers are obligated to use the proper and current approved form for all transactions.
3. Date
  - a. Typically, the date entered is when the buyer signs the offer and communicates it to the seller.
  - b. The date will be used as a reference, if needed, by citing the “contract dated.”
  - c. Most often, the offer does not become an executory contract until a later date.

**III. AGREEMENT****A. Purpose**

1. This section of the contract creates a bilateral contract and is used to define the parties and the property.
  - a. The agreement sets up the consideration for the contract, which is the buyer promising to buy and the seller promising to sell.
  - b. Once the offer is accepted and the property is under contract (executory period), it can only be modified by written agreement from all the parties (using the Agreement to Amend/Extend Contract form).

**B. Parties and property**

1. This section defines the party's buyer and seller, the property, and what will be included or excluded in the sale.
2. Buyer—defines the buyer(s) by name so the term can be used throughout the contract
  - a. Use every buyer's full legal name.
    - (1) The buyers indicate how they wish to hold title, which could be as joint tenants, tenants in common, or some other tenancy.
    - (2) Colorado recognizes concurrent tenancies of tenants in common and joint tenancy.
    - (3) Colorado does not have tenancy by the entirety or community property.
    - (4) Remember, brokers may describe these but should not recommend any particular tenancy.
3. No Assignability—The contract is not assignable unless specified in additional provisions.
4. Seller—defines the seller or sellers by legal name
  - a. Full legal name(s) of all of the current owner(s) is(are) inserted here.
  - b. The signatures of all sellers need to be on the deed to convey the property.

5. Property—identifies and defines the property
  - a. The property is described by the legal description and the \_\_\_\_\_.
    - (1) While a legal description describes only land, the property includes any and all fixtures, improvements, and appurtenances, except those specifically excluded.
6. Inclusions—defines fixtures, personal property, trade fixtures, water rights, and other items to be conveyed
  - a. Inclusions attached—describes items of personal property now attached to the real property (fixtures)
    - (1) These items of real property will be included in the sale, unless specifically \_\_\_\_\_ under the exclusions section.
    - (2) The fixtures will transfer with the rest of the real property in the \_\_\_\_\_.
    - (3) These items will convey unless they are excluded from the offer.
    - (4) Check boxes are used for items often included.
      - (a) If an item is leased, it is listed under the Leased Items section.
  - b. Inclusions not attached—identifies personal property items that are often included or any that the buyer and seller agree in writing will be part of the sale
    - (1) Space is provided to add any other personal property items that will be \_\_\_\_\_ (e.g., stove and refrigerator).
    - (2) Typically, personal property is conveyed free and clear, but any encumbrances against the personal property are listed here.
    - (3) Personal property will transfer by a \_\_\_\_\_.
7. Parking and storage—defines if there are parking or storage spaces; typically used for common interest community properties
  - a. The parking and storage may be owned with the unit or may be for use only.
8. Leased items—lists which personal property is currently leased to the seller and will be transferred to the buyer at closing.
9. Exclusions—lists all items that the seller is excluding from the sale
  - a. Fixtures, unless listed here, will be \_\_\_\_\_.
10. Water rights will have their own separate legal description.
  - a. The water rights will be conveyed by \_\_\_\_\_ or other applicable legal instrument.
  - b. If well rights are being transferred, the seller agrees to supply the buyer with the necessary well permit information.
  - c. The buyer must submit, prior to or at closing, the required change of ownership form to the state engineer's office.

- d. If the well is not registered, the buyer must complete the registration form and pay the fees.
- e. If no broker, attorney, or title company is providing a closing service, the buyer must file the change of ownership form with the Division of Water Resources within 60 days.
- f. The buyer is advised to obtain confirmation of amounts owed and restrictions on use or transfer of water and sewer taps.

### C. Dates and deadlines

1. Defines and lists all the dates and deadlines for the document
2. This is the \_\_\_\_\_ dates appear in the contract.
3. The broker will enter dates in this table for each “referenced” section in the contract.
  - a. Note: The reference column is where the corresponding event can be found.
4. Applicability of terms—defines the legal effect of checking a box in this contract. Any item with a check box is considered negotiable.
  - a. It also defines the meaning of “N/A” (not applicable) and “MEC” (mutual execution of contract), which means the latest date on which both parties have signed.
5. In the dates or deadlines column, each blank should have a specific date, “MEC,” or “N/A.” No date or deadline should be left blank.
6. If a time-of-day deadline is specified, all objection, resolution, examination, and termination deadlines will end on the deadline at that time of day.

**Figure 3.1: Purchase Price and Terms**

Item No.	Reference	Item	Amount	Amount
1	\$ 4.1	Purchase Price	\$815,000	
2	\$ 4.3	Earnest Money		\$8,000
3	\$ 4.5	New Loan		642,000
4	\$ 4.6	Assumption Balance		0
5	\$ 4.7	Private Financing		0
6	\$ 4.7	Seller Financing		0
7				
8	\$ 4.4	Cash at Closing		165,000
9		TOTAL	\$815,000	\$815,000

### D. Purchase price and terms

1. Defines the purchase price, earnest money, financing terms, and loans being used by the buyer
2. Price and terms—A table is used to show how the purchase price will be paid at closing.
  - a. Each unshaded box has a dollar amount, a zero, or “N/A.” Shaded boxes do not have amounts entered.

- b. The cash at closing line does not include the buyer's closing costs, such as loan fees. The buyer should expect that the final cost will be higher than this figure.
  - c. The total line shows that the sources of financing add up to the amount of the purchase price.
3. Seller concession—These are most likely to occur in \_\_\_\_\_ transactions (e.g., giving the buyer money toward the down payment). Other types of concessions would be noted in additional provisions.
- a. This section lists the amount of money the seller is going to contribute to the buyer's down payment and closing costs.
  - b. The different types of fees and costs that the seller has agreed to pay on behalf of the buyer are listed in this section.
  - c. The buyer may have asked the seller to pay other costs elsewhere in the contract.
  - d. Often the sale price will be increased so the seller can give the buyer the concession without impacting the amount the seller gets from the sale. If the property appraises for the higher value, this is legal. However, the appraiser must be made aware of all concessions.
  - e. If the total seller-paid costs in the contract exceed what is allowed by the lender, the seller will not have to pay more than the total allowed costs.
  - f. If the seller offers concessions to the buyer, it affects the overall sales price and value and must be noted in the \_\_\_\_\_ after closing.
  - g. The brokers should recommend that the buyer and seller talk to a tax advisor about any tax ramifications.
4. Earnest money—defines the type of earnest money being used and who will hold the funds
- a. The earnest money amount goes in the second box.
    - (1) Record the form of payment for the earnest money here.
    - (2) The type of payment can be anything acceptable to the seller.
    - (3) \_\_\_\_\_ are the most common, provided there is time for the check to clear through the bank before closing.
    - (4) An earnest money promissory note may also be acceptable. It must be clearly \_\_\_\_\_ in the contract.
      - (a) The note *must* be collected prior to closing. There is no set time for the collection as long as the broker can bring good funds to closing.
      - (b) If received, both brokers sign a receipt for this money at the bottom of the contract. The listing broker has three business days after notice of \_\_\_\_\_ to deposit the earnest money in the listing brokerage firm's trust (escrow) account.
    - (5) The buyer's broker is obligated to deliver the earnest money to the listing broker/firm \_\_\_\_\_ upon acceptance of the offer.
    - (6) This section gives express authority to the listing brokerage firm to hold the earnest money until closing or defeat of the \_\_\_\_\_.

- (7) If the earnest money is not attached and part of the offer but will be delivered at a later date, the alternate date is listed in the dates and deadlines section.
  - Note: This is the first item and date to be listed in the section.
- (8) This also establishes a process and time frames for the buyer's earnest money to be returned.
  - (a) The seller agrees to sign and return an Earnest Money Release form within three days, if requested.
  - (b) The return of earnest money is conditioned upon there being no dispute.
- 5. Form of funds; time of payment; funds available—defines the type of funds required for closing and gives notice if the buyer has the funds at the time of the offer
  - a. Colorado law requires that the buyer pay the balance of the purchase price in good funds at closing, which includes the forms of payment listed in this subsection.
  - b. The buyer represents that the buyer does or does not have the cash available now.
    - (1) This reminds the parties that all funds must be brought to closing or the party will be in default.
    - (2) The buyer is informed that any loan costs and other closing costs may increase the amount the buyer will have to bring to closing.
- 6. New loan—This section states the buyer may pay cash or select acceptable financing.
  - a. The buyer agrees to pay loan costs, subject to concessions not prohibited by the lender.
  - b. The buyer is given notice that the buyer may select appropriate financing, and if FHA or VA financing is selected, the seller agrees to pay any costs or fees that are not permitted to be paid by the buyer, up to a negotiated amount.
  - c. A pre-application conference with a lender may influence the buyer's choices.
  - d. The buyer is advised to review the terms, conditions, and costs of any new loan carefully.
  - e. The buyer is notified that, in most cases, the lender must supply a loan estimate form within three days after loan application.
- 7. Assumption—establishes the loan terms and conditions for a buyer assuming the seller's current loan
  - a. The buyer must know the terms of the existing loan being assumed; typically, the listing broker gives this information.
  - b. On an assumed loan, the buyer will pay any loan transfer fee.
- 8. Seller or private financing—establishes the loan terms and conditions for a buyer using seller financing
  - a. A seller or some other private party may provide partial or complete financing of the purchase.
  - b. The section warns that the financing documents should be prepared by a Colorado attorney or licensed mortgage broker. Real estate brokers may not complete mortgage forms.

- c. If the private financing is a large amount, it may be appropriate to request that the buyer supply the seller with a mortgagee's title insurance policy similar to those required by traditional lenders.
- d. The seller or buyer may terminate on or before the seller or private financing deadline if financing is not satisfactory.

#### **IV. TRANSACTION PROVISIONS**

##### **A. Purpose**

- 1. This segment of the Contract to Buy and Sell Real Estate establishes and defines buyer and seller agreements about financing, appraisal, title work, title matters, and surveys.

##### **B. Financing conditions and obligations**

- 1. This section creates and clarifies the obligations of the buyer in regard to the deadlines and actions that need to be taken to obtain financing. The buyer is expected to act diligently within the time frames to make sure financing is complete by closing.
- 2. Loan application—establishes the obligations of the buyer to complete a loan application and set the dates and deadlines for the buyer to complete it
  - a. The buyer agrees to make a verifiable application by the loan application deadline.
  - b. The application is used for a new loan or for a loan assumption with lender qualification of the buyer.
  - c. The buyer agrees to exercise reasonable efforts to obtain the loan or loan approval.
- 3. New loan review—terms; new loan availability
  - a. If the buyer is not satisfied with the new loan terms, the buyer may terminate the contract no later than the new loan terms deadline listed in the dates and deadlines section.
  - b. If the buyer is not satisfied with the availability based on review and underwriting guidelines, the buyer may terminate no later than the new loan availability deadline listed in the dates and deadlines. The buyer may not use this deadline to terminate based on loan terms, appraised value, lender property requirements, insurability, or a contingency on the sale of other property.
  - c. The buyer is warned that if the seller does not receive timely written notice to terminate before the deadline, the buyer's earnest money will be nonrefundable.
  - d. The loan termination deadline should be set so that it is after the appraisal deadline.
  - e. This is a negative consent provision (as are most contingencies in the contract). If the buyer does not respond by the loan termination deadline, the buyer waives the condition and accepts the risk of losing the earnest money deposit if the buyer cannot get a loan.
    - (1) A negative consent provision means that one party has a right to object to something or even terminate the contract with written notice to the other party.
    - (2) If the party does nothing, the party waives the right to object or terminate under the provision. The contingency is terminated, not the contract.



4. Credit information—this section is applicable for seller-carry financing of all or part of the purchase price or for assumption of seller's existing loan without release of seller's liability
  - a. This establishes the deadlines for the buyer's submittal of buyer's credit and the seller's disapproval. The buyer must pay for the credit report and other information.
  - b. Credit approval is "at seller's subjective discretion."
  - c. The seller \_\_\_\_\_ the buyer's credit information with others.
  - d. Disapproval by the seller \_\_\_\_\_ the contract and must be done on or before the disapproval of buyer's credit information deadline.
5. Existing loan deadline—this section sets deadlines related to the buyer's completing a loan assumption
  - a. The seller (usually through the listing broker) must supply loan documents for the buyer to review by the existing loan deadline.
  - b. If the seller is to be released from liability or have VA eligibility reinstated, those must be included in the approval, or the seller has the option to terminate the contract.
  - c. The buyer has an opportunity to review the documents and terminate the contract if the terms are unsatisfactory, as long as the buyer responds by the existing loan termination deadline.
  - d. The buyer must also obtain the lender's approval for loan assumption by the loan transfer approval deadline or the contract will terminate.

### C. Appraisal provisions

1. This section is used to create or eliminate the appraisal contingency. It also determines who will pay for the appraisal.
2. Appraisal is defined and notice is given that the lender may add conditions, such as repairs, as part of the process.
3. Appraised value—creates the appraisal contingency based on the type of loan the buyer is using. Cash buyers who want an appraisal will use the conventional/other section.
  - a. Conventional/other—used for a buyer seeking a conventional, non-FHA or VA, or other loan, or for cash buyers
    - (1) If the appraised value is \_\_\_\_\_ the contract price, or the buyer has not received the appraisal, the buyer can offer an objection or terminate the contract without forfeiting the earnest money.
    - (2) If offering an objection, the buyer must attach the appraisal or a letter from the lender showing that the appraisal price is lower than the purchase price. This offers the seller and buyer time to negotiate a resolution to the lower price.
    - (3) The buyer and seller must agree to a written resolution or the buyer must withdraw the objection prior to the appraisal resolution deadline or the contract will terminate.

- b. FHA and VA requirements—used to meet the specific provisions required by the FHA and VA to have an escape clause if the property does not appraise for the contract price
  - (1) The escape clause allows the buyer to terminate the contract.
  - (2) The VA section offers the seller the right to terminate if the lender imposes property improvements above what the seller is willing to pay for.
- 4. Cost of appraisal—determines who will pay for the appraisal
  - a. The parties \_\_\_\_\_ who will pay for an appraisal obtained after the contract date.
  - b. Notice is given that the cost of the appraisal may include any or all fees paid to the appraiser, appraisal management company, lender's agent, or all of these.

#### **D. Association documents**

- 1. Homeowners association disclosure and documents—If the property is in an HOA, also known as a common interest community, the buyer is made aware that such communities are governed by bylaws, rules, and regulations.
  - a. A common interest community is any community with a \_\_\_\_\_ for the maintenance of common facilities (common elements).
  - b. The Colorado Common Interest Ownership Act provides homeowners associations with statutory lien power for unpaid assessments. This means the association has the right to foreclose if the assessments are not paid.
  - c. Common interest community disclosure—Printed in all capital letters and bold, the section warns the buyer about many of the issues involved with common interest communities.
    - (1) The buyer should fully understand all of these issues and know that he has an obligation to
      - (a) follow the rules and regulations;
      - (b) pay all assessments, both monthly and special (if required), along with any other financial obligations; and
      - (c) abide by the requirements on exterior changes.
    - (2) This section obligates the seller to provide association documents to the buyer at the seller's expense and authorizes the association to provide documents to the buyer at the seller's expense.
      - (a) These documents include the bylaws, rules, and regulations, minutes for association meetings, and the community's annual documents such as the balance sheet, income, expenditures, and budget.
      - (b) The date of delivery is set in the dates and deadlines section.
      - (c) It creates the opportunity for the buyer to review and gives the buyer a negative consent responsibility to object by the association documents objection deadline or \_\_\_\_\_.
      - (d) If the buyer does not receive the documents until after the association documents deadline, the buyer will have ten days to terminate the contract. If the documents are not received by closing, any Notice to Terminate must be received by the seller before closing.

**E. Evidence of title**

1. This section deals with title issues and establishes that the seller is providing title insurance. The type of policy or abstract is also determined.
2. Evidence of title and copies of exceptions—sets the type of owner's policy and determines who will select and pay for it
  - a. A check box determines if the seller or buyer will choose the title company and pay for the title insurance.
    - (1) The party choosing the title company is the one who pays for the policy.
    - (2) RESPA requires that if the buyer pays for all or any portion of the title insurance, the buyer may then choose the title company.
  - b. It gives the buyer the right to request documents listed as exceptions in the title commitment.
  - c. The buyer may request an owner's extended coverage (OEC) policy, which would include insurance coverage for the six items listed.
    - (1) Once again, check boxes will determine who will pay for the extended coverage.
  - d. The title commitment is delivered by the record title deadline and is an \_\_\_\_\_ to insure the title.
    - (1) The title commitment is delivered prior to closing, but the actual policy is delivered after closing.
  - e. The buyer has a \_\_\_\_\_ to review various title documents and exceptions listed in the title commitment.

**F. Record title and off-record title matters**

1. This section sets the dates and requirements for the review of the title and survey. The buyer will have time to review all the documents and object to any that are not acceptable.
2. The buyer or buyer's attorney has until the title objection deadline to report any title defect believed to make the title unmerchantable or report if the form or content of the title commitment is unsatisfactory.
  - a. The buyer will have the right to terminate if unsatisfactory title issues are found.
  - b. If a later endorsement from the title insurance company adds any exclusions, the buyer will have five days after receipt to object.
  - c. The seller may be aware of items such as leases or recent easement agreements that are not shown in the public record.
    - (1) The seller must provide copies by the off-record title deadline.
    - (2) The buyer has until the off-record title objection deadline to object in writing.
  - d. The dates for the buyer to object to title issues, the seller to resolve them, and the right to terminate the contract if the issues cannot be settled are defined here and entered in the dates and deadlines section.

3. Special taxing districts—gives the buyer notice that special taxing districts may represent a substantial \_\_\_\_\_ risk to a buyer, so the buyer should investigate the district
  - a. Both title documents and the county certificate of taxes due will normally list such taxing districts.
  - b. Financial information about the district is available from the State of Colorado.
  - c. The buyer must receive a tax certificate prepared by the county treasurer listing any special taxing districts by the record title deadline.
  - d. If the buyer disapproves of the district, the buyer may terminate by the record title objection deadline. If the buyer receives the certificate after the deadline, the buyer may terminate on or before closing.
  - e. Payment for the tax certificate is negotiable.
4. Right of first refusal or approval—A few common interest communities have a right of first refusal to acquire a property with priority over a potential new buyer or a right to approve sales.
  - a. If such a right exists, the seller is responsible to either get an approval or waiver by this deadline.
5. Title advisory—warns the buyer about the seriousness of title matters. In particular, it explains that mineral and water rights may not be part of the sale.
  - a. A third-party owner of the mineral or other rights may have the right to \_\_\_\_\_. The third-party owner must restore the surface of the property.
  - b. This section warns the buyer
    - (1) that someone else may own and control the mineral and subsurface rights with the right of access;
    - (2) that adjacent properties may have wells or other extraction activities that can impact enjoyment of the buyer's property;
    - (3) to seek advice of legal or other counsel; and
    - (4) that mineral rights are not covered by title insurance.

#### **G. Current survey review**

1. This section requests a new survey, new improvement location certificate (ILC), or other document to determine the property's boundaries.
2. If a survey or an ILC is required for extended title insurance or for a lender, this section specifies who will order and pay for it.
3. Dates for the delivery of the documents and the rights to objection are put in the dates and deadlines section.

# UNIT 4

## Colorado Contract to Buy and Sell Real Estate, continued

### UNIT 4 LECTURE OUTLINE

#### I. DISCLOSURE, INSPECTION, AND DUE DILIGENCE

##### A. Property disclosure, inspection, indemnity, insurability, due diligence, buyer disclosure, and source of water

1. Establishes various items tied to the disclosure of defects and the buyer's right to have a property inspection
2. Seller's property disclosure deadline—establishes if the seller will agree to give the buyer a Seller's Property Disclosure by the deadline listed
  - a. The seller agrees by contract to provide the most current version of the Real Estate Commission–approved Seller Property Disclosure form before this deadline.
    - (1) The seller completes the form to “the seller’s \_\_\_\_\_,” current as of the date of the contract.
    - (2) The seller still has the right to sell the property in “as is” condition.
  - b. State law does not require this disclosure form to be a part of the real estate transaction, but the approved listing contract and the Contract to Buy and Sell Real Estate requests that the seller provide it.
    - (1) If the seller chooses not to provide the disclosure, the seller must state this in the listing contract. The seller would also need to counter the offer to remove this provision from the Contract to Buy and Sell Real Estate.

### 3. Disclosure of adverse material facts; present condition

- a. The seller agrees to give written disclosure of all known adverse material facts known as of the date of the contract.
  - If the seller discovers an adverse material fact after the date of the contract, the seller must disclose it. The buyer has the right to terminate.
- b. The buyer is given notice that the property is being sold in an “as is” condition, “where is,” and “with all faults.”
- c. Inspection—gives the buyer permission for an inspection and other tests, and sets time frames for the buyer to complete the property inspection and then either terminate the contract or request repairs from the seller
- d. The buyer has the right to have the property, inclusions, and surrounding areas inspected by an inspector of the buyer’s choice and at the buyer’s expense.
- e. After the inspection, the buyer has three choices before the inspection objection deadline:
  - (1) Do not give notice before the deadline and let the contingency expire (waive the right to object).
  - (2) Terminate the contract on or before the inspection termination deadline.
  - (3) Use the Inspection Objection form to give the seller a written list of items that are unsatisfactory and must be corrected.
    - (a) If the buyer and seller cannot reach a written agreement by the resolution deadline on what will be corrected and how, the contract will terminate \_\_\_\_\_.

### 4. Damage, liens, and indemnity—the buyer agrees to indemnify (protect) the seller from any claims and liens for the buyer’s failure to pay for the work

- a. The buyer is responsible for any damage done to the property during inspection or testing.
- b. The buyer will pay for the inspector and any other work that was done and agrees that no claims or liens can be placed against the property as a result of the buyer’s failure to pay for the work.
- c. Even if the buyer \_\_\_\_\_, the buyer remains responsible for repairing the damage.

### 5. Insurability—The buyer is given a contingency to find satisfactory insurance by the deadline.

- a. The buyer may shop for property insurance, and if the buyer is unable to get satisfactory insurance by the property insurance termination deadline, the buyer may terminate the contract by written notice.

### 6. Due diligence, documents, and deadlines—establishes due diligence requirements

- a. This gives the buyer the option to inspect the physical components of the property (e.g., roof, structure, and mechanical systems).
- b. In the income, commercial, and land versions of the Contract to Buy and Sell Real Estate, a standard list of requested documents is incorporated in this section.

- c. The buyer has this space to request documents from the seller, and the seller agrees to provide the documents, if in the seller's possession, by the due diligence document delivery deadline.
  - d. The buyer is given notice and deadlines for terminating the contract if the buyer is not satisfied with the due diligence documents, survey, or leases as applicable.
7. Conditional upon sale of property—The buyer notifies the seller if the buyer must sell a current property in order to close on the property on which the buyer is making an offer.
- a. If the buyer needs to sell another property, this section will create the contingency for the sale and deadline for completion.
8. Source of potable water (residential land and residential improvements only)—The buyer is given notice to confirm the source of water.
- a. The buyer acknowledges if the buyer has received the Seller's Property Disclosure or the source of water addendum, which discloses the source of potable water for the property.
  - b. The buyer will verify if the buyer has received a copy of the current well permit, or if there is no well on the property.
  - c. The buyer is, once again, notified to investigate the long-term sufficiency of the water supply.
9. Carbon monoxide alarms—alerts the buyer and seller to the statutory requirements for carbon monoxide alarms
- a. The parties acknowledge that if the property has fuel-fired heaters or appliances, a fireplace, or an attached garage, there must be operational carbon monoxide alarms installed within 15 feet of the entrance to each bedroom or in a location required per building code.
10. Lead-based paint—used to make sure all parties are in compliance with the lead-based paint law
- a. The lead-based paint disclosure is mandatory for a residential improvement with a \_\_\_\_\_ prior to January 1, 1978.
  - b. The contract must be signed by the seller, the buyer, and all licensees.
  - c. The disclosure is the \_\_\_\_\_ alone. The broker's duty is to help the seller meet the seller's obligation.
  - d. The seller and the licensees must sign and give the buyer the disclosure by the lead-based paint disclosure deadline.
    - If the buyer does not timely receive the lead-based paint disclosure, the buyer may waive the failure to timely receive the lead-based paint disclosure or exercise the buyer's right to terminate under § 24.1 by the seller's receipt of the buyer's Notice to Terminate on or before the expiration of the lead-based paint termination deadline.
11. Methamphetamine disclosure—If the seller knows that methamphetamine was ever manufactured, processed, cooked, disposed of, used, or stored at the property, the seller is required to disclose such fact.
- a. No disclosure is required if the property was remediated in accordance with state standards.
  - b. The buyer has the right to terminate upon the seller's receipt of the buyer's written Notice to Terminate, based on the buyer's test results that indicate the property has been contaminated

with methamphetamine but has not been remediated to meet the standards. The buyer must promptly give written notice to the seller of the results of the test.

## **II. CLOSING PROVISIONS**

### **A. Closing documents, instructions, and closing**

1. The buyer and seller negotiate who will be responsible for the payment of various closing costs and fees. All funds brought to the closing will be in the form of good funds. The section also states who will be responsible for setting the time and place where all the parties will meet to close.
2. Closing documents and closing information
  - a. Closing instructions, closing, and disclosure of settlement costs—The buyer and seller agree to furnish any additional information or documents needed by the closing company and negotiate who will pay various fees related to the transfer of ownership.
    - (1) A check box states if the closing instructions are being executed with the contract.
    - (2) If the instructions are not part of the contract, either the seller or buyer is chosen to deliver the instructions to the closing company.
      - (a) Closing is defined as delivery of deed on the closing day or, by mutual agreement, at an earlier date. The seller agrees to deliver a set of keys at closing.
    - (3) The offeror (normally the buyer) proposes a date for closing (settlement) and the buyer and seller agree on a negotiated date.
    - (4) This section sets the date in the dates and deadline section and designates who will specify the time and location of closing.
      - (a) The seller and buyer are given notice that the costs for settlement service providers and services vary.

### **B. Transfer of title**

1. The seller agrees to convey title to the property free and clear of encumbrances and agrees to which type of deed will be used to convey the title.
2. The seller commits to provide a good and sufficient warranty deed at closing unless another deed is selected.
3. The seller agrees to deliver title free and clear of liens and encumbrances, unless the buyer has assumed them. This includes special assessments.
4. There is a list of “standard” exclusions from the “free and clear” status and a place to list any other exclusions.
5. A special warranty deed warrants title “by, through or under seller.” A general warranty deed warrants the title subject only to specific recorded exceptions.

### **C. Payment of encumbrances**

1. Unless agreed to by the buyer, any liens or encumbrances will be paid at closing by the seller from \_\_\_\_\_.



**D. Closing costs, closing fee, association fees, and taxes**

1. The buyer and seller negotiate who will be responsible for the payment of various closing costs and fees. All funds brought to the closing will be in the form of good funds.
2. How the fees for the closing service will be paid is \_\_\_\_\_ here.
3. A Colorado documentary fee of \_\_\_\_\_ is payable by the person recording a conveyance deed. This fee is typically paid by the buyer.
4. The seller agrees to request an association status letter at least 14 days before closing. Payments for a homeowners association status letter and any outstanding assessments as part of the transfer from the seller to the buyer are negotiated.
5. Water transfer fees, if any, are listed here.
6. Local transfer taxes are usually treated like a sales tax and paid by the buyer.
7. Colorado use tax is primarily for personal property used in a business. It is the legal responsibility of the \_\_\_\_\_ since it is like a sales tax.
8. FIRPTA and Colorado withholding—If the seller is a foreign person for U.S. income tax purposes or will not be a Colorado resident after closing, the seller authorizes the title company to withhold a portion of the seller's proceeds for taxes. The seller is advised to consult with the seller's tax advisor.

**E. Prorations**

1. This section will describe and define how property taxes, rents, association fees, and any other items will be prorated at closing between the seller and buyer. It also defines how all items will be prorated at the final settlement.
2. Colorado practice is to \_\_\_\_\_. The seller's last day of responsibility is the day before closing; the buyer is responsible the entire day of closing.
3. General real estate taxes are prorated as indicated by the box checked, either by using the previous year's taxes or the most recent mill levy.
4. If the property is subject to a lease, the rent will be \_\_\_\_\_ as indicated.
  - a. Security deposits are not prorated; they will be credited to the buyer.
  - b. The seller agrees to notify the tenants of the transfer and the name and address of the new buyer who is holding the deposit.
5. If the property is part of an HOA, this section determines how the charges will be prorated.
  - a. The Colorado Common Interest Ownership Act authorizes homeowners associations to place a \_\_\_\_\_ lien on owners who fail to pay association dues.
  - b. Regular association assessments and dues will be prorated. Any other special assessments are the responsibility of the party indicated.
  - c. The seller represents that there are no unpaid regular or special assessments and states that these assessments are current.
  - d. Association reserve funds will be ignored unless association documents require something different.

- e. The buyer acknowledges the buyer may be requested to pay, at closing, additional amounts for association reserves or working capital.
  - f. Any special assessment for improvements installed before the date of the contract is the seller's responsibility.
6. Sometimes a buyer or seller will protest a proration if the final bill, such as a tax bill, comes in higher or lower than the assumed and prorated amount.
  7. This provision says the prorations are final unless otherwise agreed to in additional provisions.

#### **F. Possession**

1. This section will determine the date and time for the seller to turn over possession to the buyer.
2. The best time for possession is at the closing, after the deed has been delivered and the buyer's payment has been received.
3. If the seller is to remain after closing, there may be issues involving insurance and the seller leaving in a timely fashion.
  - a. If the seller stays after closing, then a post-closing occupancy agreement should be completed. This section states that the seller could be subject to eviction, and there is a space to charge the seller a daily fee if possession is not delivered as agreed.
4. Possession date and possession time are two more items in the dates and deadlines table.
5. The buyer's occupancy intentions are important for the type of financing the buyer is requesting.
6. The property insurance coverage should be verified.

### **III. GENERAL PROVISIONS**

- This section is used to define the general terms and conditions of the Contract to Buy and Sell Real Estate.

#### **A. Causes of loss, insurance; condition of, damage to property and inclusions and walk-through**

1. This section defines what will happen if the property is damaged during the executory period, along with the seller's obligations if one of the inclusions fails. The buyer is also given other rights to verify the property's condition.
2. The seller is obligated to deliver the property and inclusions as they were represented in the Seller's Property Disclosure or as provided in the contract.
3. Cause of loss, insurance—explains what happens if the property is damaged by fire or other casualty
  - a. The remedies are different if the damage is more or less than \_\_\_\_\_ of the purchase price.
    - (1) If there is 10% or less damage, the seller will repair the property.
    - (2) If the damage is over 10%, the buyer may terminate or collect insurance proceeds for the real property damage.

4. Damage, inclusions, and services—If an inclusion fails between the contract date and closing, the seller must repair it or replace it with “a unit of similar size, age, and quality.” The parties might also agree to an equivalent credit at closing.
  - a. If the seller does not replace the inclusion, the buyer may terminate the contract or receive a credit.
  - b. The contract also reminds a buyer that a pre-owned home warranty may be available.
5. Condemnation—In the event the property is condemned, this section sets up remedies for the buyer.
  - a. The buyer may
    - (1) terminate the contract, or
    - (2) proceed and collect the funds from the condemnation.
6. Walk-through and verification of condition—The buyer is given the right, with notice to the seller, to walk through the property prior to closing to verify the physical condition of the property and the inclusions.
  - a. The buyer must be aware that this walk-through is not another \_\_\_\_\_ clause, but an opportunity to make sure that agreed corrections and conditions are satisfactory.
7. Home warranty—notifies the parties of the existence of pre-owned home warranty programs.

#### **B. Recommendation of legal and tax counsel**

1. As in all approved contracts, this section confirms that the brokers recommend that all parties seek legal and tax counsel prior to signing.
  - a. This confirms that the broker carried out duties as required.

#### **C. Time of essence, default, and remedies**

1. The buyer and seller are agreeing to the remedy if the other party is in default. Specific performance is an option available to either party, with the seller having the additional choice of liquidated damages.
  - a. This section makes every relevant date and deadline strictly mandatory to avoid default.
  - b. Payments must be made on time, and checks and notes must be paid to avoid being in default.
  - c. The remedies for the party not in default are listed.
2. If buyer is in default—creates the choices the buyer can make if the buyer defaults on the contract
  - a. Unless the box is checked for specific performance, liquidated damages is automatically chosen.
  - b. Specific performance allows the seller to cancel the contract, keep the earnest money, and sue the buyer for damages, or take the buyer to court to force the buyer to perform the purchase terms and sue for additional damages.
  - c. Liquidated damages (the default if no box is checked) provides that the seller may only keep the earnest money.

3. If seller is in default—gives the buyer notice of the buyer's only remedy if the seller defaults on the contract
  - a. The buyer has remedies parallel to the \_\_\_\_\_ remedies described under buyer default.

Note: The only remedy available to both parties in approved contracts is \_\_\_\_\_.

#### **D. Legal fees, cost, and expenses**

1. This section sets up who will be responsible for legal fees.
2. If the parties end up in binding arbitration or a suit in court, the losing side may be ordered to pay the expenses, including attorney fees, for the prevailing side.

#### **E. Mediation**

1. As in all approved contracts, the parties (buyer and seller) are agreeing to first use nonbinding mediation to try to settle any dispute.
2. The parties agree to mediate for \_\_\_\_\_ and will split the cost of the mediation evenly.
3. Any resolution reached and signed by the parties will be binding on the parties.
4. If mediation does not settle the situation, either party may take the matter to arbitration or litigation (lawsuit). The lawsuit or lis pendens may be filed during the mediation period.
5. The right to mediation is standard in every approved contract and is not negotiable.

#### **F. Earnest money dispute**

1. If the parties are in dispute and the earnest money is in contention, this section defines the brokerage firm's options.
2. When a contract is terminated according to one of its provisions, the earnest money must be returned immediately unless there is a specific dispute.
  - a. This section protects \_\_\_\_\_ in case of an earnest money dispute.
  - b. The buyer and seller still mediate the dispute, but the broker is not under pressure to disburse the funds.
  - c. The brokerage may do one of the following with the earnest money:
    - (1) Take no action and hold the funds pending a resolution, which is typically at least through the mediation process.
    - (2) Interplead the parties in a civil action to determine the disposition.
      - (a) *Interpleading* is a process where the broker deposits the funds in court and starts a legal action for the court to decide how the money will be disbursed.
      - (b) The broker may recover the costs of setting up this court action.

- (3) Notify the buyer and seller to send any lawsuit information or the money will be returned to the \_\_\_\_\_ of notice being sent.
- (4) Disburse the money per the court order or as directed in writing by the buyer and seller.

#### **G. Termination**

1. If the buyer or seller terminate the contract as agreed, by giving the other party written notice prior to a deadline or as otherwise defined, the buyer's earnest money will be returned.
2. The section defines *termination* for all the times in the contract when one party may terminate the contract.
3. If the contract is terminated as agreed, the parties will be relieved of any contract obligations other than those defined in the inspection, mediation, and earnest money dispute sections.

#### **H. Entire agreement, modification, survival**

1. The parties are agreeing that everything that has been negotiated, both written and verbal, is contained in this contract.
2. This clause confirms that there are no side agreements and all parties acknowledge that this is the entire agreement.
3. Modifications after the contract is executed must be made in writing and signed by both parties.

#### **I. Notice, delivery, and choice of law**

1. This section states that all notices must be in writing and describes the methods that are acceptable for official notice between the parties.
  - a. Physical delivery
    - (1) Delivery of official notice by one party to the other shall be by physical delivery except as allowed in the next section.
  - b. Electronic delivery
    - (1) The buyer chooses whether to accept notice by facsimile, internet, or email. Any party may request documents with original signatures at any time.
  - c. Choice of law
    - (1) Colorado law applies to any dispute or interpretation of this contract.
      - Under Colorado law, an electronic signature is “any identifier or authentication technique attached to or logically associated with an electronic record that is intended by the person using it to have the same force and effect as the use of a manual signature (24-71-101 C.R.S.).

#### **J. Notice of acceptance, counterparts**

1. This section determines the deadline for acceptance of the offer. The offer will expire if not responded to in the time frame outlined.

2. It creates the date and time for acceptance of the offer.
  - a. The acceptance deadline should normally be as short as is reasonable for the seller to review the offer and respond.
  - b. The acceptance deadline time should be a clock time that is reasonably convenient for the parties—normally not midnight.
  - c. The buyer may \_\_\_\_\_ the offer at any time until the buyer or the buyer's representative learns of acceptance of the offer.

#### **K. Good faith**

1. The seller and buyer acknowledge their obligations to act in good faith to meet all the requirements of the contract.
  - a. This includes, but is not limited to, those outlined in the financing, property disclosure, inspection, indemnity, insurability, and source of water sections.

### **IV. ADDITIONAL PROVISIONS AND ATTACHMENTS**

- This section defined the additional items added to or attached to the offer.

#### **A. Additional provisions**

1. As in all approved Colorado contracts, this section is used for transaction-specific items negotiated between the parties.
  - Example: If the buyer would like the seller to leave the firewood, the buyer would make that request in this section.
2. Transaction-specific agreements negotiated between the buyer and seller are proper in this area. Most other items belong in an addendum.
3. The Real Estate Commission clearly limits the contents of additional provisions to those negotiated by the parties, and any transaction-specific clause used by the broker that was drafted by the firm's attorney must be clearly understood and used appropriately.
4. "A broker who is not a principal party to the contract may not insert personal provisions, personal disclaimers, or exculpatory language in favor of the broker in the additional provisions section of a Commission-approved form."
  - No broker exculpatory language is permitted in the Contract to Buy and Sell Real Estate.

#### **B. Other documents**

1. This section is used to list additional documents that are being attached to the contract, such as addenda with a lengthy legal description, the Lead-Based Paint Disclosures, or the Seller's Property Disclosure.
2. Some attachments are part of the legal contract, and others may be for information only, such as a Square Footage Disclosure form, Post-Closing Occupancy Agreement, or Seller's Property Disclosure form.
3. This section is not for items included in or excluded from the sale of the property. (These are listed in Section 2 of the contract.)

**V. SIGNATURES**

- To be legally binding, the contract must be signed by all buyers and sellers.

**A. Buyer and seller signatures**

1. The buyer signs when making the offer.
  - a. The buyer's broker should complete the buyer information.
2. The seller would sign if accepting the offer "as is."
  - a. The listing broker should make sure the seller information is complete and correct.
3. If the seller has not accepted the offer as proposed, the seller does not sign. The note reminds the seller, "If this offer is being countered or rejected, do not sign this document."

**B. End of contract**

1. Informs all parties that additional information below this point is not part of the contract between the buyer and seller.

**C. Broker's acknowledgments and compensation disclosure**

1. Defines the brokerage relationships and if the brokers are holding the earnest money.
2. When they sign, there is a checkbox for brokers to acknowledge receipt of the earnest money.
  - a. Brokers are agreeing that if the brokerage is holding the earnest money and receives a request for return of the funds, the brokerage will return the earnest money to the buyer within five days of receiving the request due to timely termination.
3. The brokers also acknowledge their relationship in the transaction.
4. Each company completes the relevant parts.
5. Each firm confirms the source of its commission.
6. The brokers should provide complete information to speed up communication.

**VI. CHANGE OF STATUS FORM****A. Purpose**

1. Gives notice to all parties who have a current agency listing that the broker, as agreed, is becoming a transaction-broker for the current transaction.

**B. Key points**

1. If a broker is designated as an agent broker for a buyer or seller (or both) and double-ends the transaction (works with both parties), then the broker \_\_\_\_\_ from agent broker (single agent) to a transaction-broker (representing both sides) or resign one of the designated assignments.
2. If the broker has a brokerage relationship with either or both parties, the broker changes to a transaction-broker.

3. The party or parties have agreed to this change by signing and dating this document.
4. The broker must notify the parties whose relationship will change. If both the buyer and seller had agency contracts with the broker, both should be notified.
5. This form is used to disclose a change in relationship from agency to transaction-broker at the time the change takes place.
6. It states that the change is for this transaction only. The relationship between the broker, buyer, and seller will remain the same for any other transactions or if this one fails.
7. The broker checks the box for the contracts the broker has with the parties. One form is designed for both sides in one transaction.
8. This is \_\_\_\_\_ or new agreement. The parties already agreed to make this change in listing and buyer representation contracts.
  - a. This form is notification that the change has occurred and the broker is no longer an agent for this potential transaction only.



# UNIT 5

## Additional Transaction Documents and Regulations

### UNIT 5 OVERVIEW

#### **Additional Forms Used with the Approved Contract Forms**

- Lead-Based Paint Disclosures
- Square Footage Disclosure
- Seller's Property Disclosure (all types of properties)
- Source of Water Addendum to Contract to Buy and Sell Real Estate
- Closing Instructions
- Counterproposal
- Post-Closing Occupancy Agreement
- Inspection Objection
- Inspection Resolution
- Agreement to Amend/Extend Contract (used with Contract to Buy and Sell Real Estate only)
- Listing Contract Amendment (used with listing or buyer representation contracts)
- Notice to Terminate
- Licensee Buyout Addendum to Contract to Buy and Sell Real Estate
- Short Sale Addendum
- Statutory Power of Attorney for Property
- Property Transfer Declaration (TD-1000 used at closing)

## Colorado Regulations

- Water rights
- Well permits
- Deeds of trust law and foreclosure in Colorado
- Colorado Foreclosure Act
- Equity skimming
- Uniform Consumer Credit Code
- Dual contracting
- Adverse possession and prescription in Colorado
- Taxation of real property

## Colorado Real Estate License Rules

- Subdivision registration
- Errors and omissions insurance
- Employing broker supervision
- Employee and independent contractor status
- Real estate assistants

## Additional Documents

The additional documents illustrated and explained in this unit are frequently part of the negotiation, contracting, and closing parts of a real estate transaction. Licensees are responsible for knowing that these documents exist and using the proper approved form throughout their real estate careers. The forms are organized in roughly the same order they might be used in an actual transaction.

## Additional Regulations

The additional Colorado regulations and real estate commission rules are also an important part of any proper real estate practice. Brokers should know that the rules exist and how to access them.

# ADDITIONAL FORMS

In addition to approved contract forms, the Colorado Real Estate Commission has approved other forms for brokers to use. This unit will review these forms and regulations that impact Colorado real estate professionals.

## Lead-Based Paint Disclosures

Federal law places the responsibility on the seller or the landlord to disclose lead-based paint. Even an unrepresented seller (for sale by owner) must disclose. Three forms for disclosing lead-based paint have been approved for use by brokers. The first form is the Lead-Based

Paint Obligations of Seller, which is used to inform the seller or the landlord of the federal requirements to disclose to buyers or tenants. The second and third required forms are the Lead-Based Paint Disclosures (Sales) and Lead-Based Paint Disclosures (Rentals). Property owners and brokers must use these forms for all properties with building permits prior to January 1, 1978. Note that the federal law only states properties built before January 1, 1978, but Colorado law clarifies that it applies to properties with building permits prior to January 1, 1978.

The lead-based paint disclosure forms have five sections. The first is a description of lead-based paint and lead-based paint hazards. The second discloses whether or not the landlord or the seller has any knowledge regarding lead-based paint on the property. Also, the section has an area to note whether or not the landlord or the seller has reports in regard to lead-based paint. The tenant or the buyer uses the third section to acknowledge receipt of the disclosure and the federal pamphlet *Protect Your Family from Lead in Your Home*. The sales-specific form gives buyers further notice of their right to have ten days to have the property inspected for lead-based paint. If the buyer chooses to have the property inspected, the amount of time will be determined by the inspection section of the Contract to Buy and Sell Real Estate, which may or may not be ten days. The form also gives the buyer the choice to waive any assessment or inspection of the property. The fourth section gives notice and acknowledgment of the real estate licensee's obligation to both inform the owner of the owner's obligation to disclose and the licensee's responsibility to ensure compliance with the disclosure of all parties. The fifth and final section records the signatures of the buyer, the seller, and the licensees representing them.

In the sale of a property that requires a lead-based paint disclosure, the Contract to Buy and Sell Real Estate calls for the buyer to receive the disclosure before the seller accepts the offer, or the contract will be void. To make sure that the buyer receives the form, the listing broker should complete it at the listing appointment. There is a deadline in the dates and deadlines section for the lead-based paint disclosure to be delivered. When an offer is being written, the seller and the listing broker sign the form and then send it to the buyer's broker. The buyer's broker presents and reviews the form with the buyer, who signs the form. Typically, the last signature belongs to the buyer's broker who, in order to provide compliance, attaches the completed Lead-Based Paint Disclosures form to the Contract to Buy and Sell Real Estate when presenting the offer to the seller.

Sellers and landlords are not required to test for or remove lead-based paint. They must make sure all buyers and tenants receive the pamphlet and disclosure form so the buyers and tenants can make an informed choice about the property they are buying or leasing.

## Square Footage Disclosure

The listing broker of residential property uses the Square Footage Disclosure to comply with Commission rules. The rules require any broker who lists and markets residential property to disclose the source of the square-footage measurement. The form gives the listing broker two options for square footage disclosure: (1) the licensee's measurements, or (2) an outside source of measurement. If using the first section, "Licensee Measurement," the broker checks the appropriate box to note that either the broker measured the property or someone else measured the property. The licensee uses this section to describe which standard of measurement was used. The broker can choose to use exterior measurement, FHA, ANSI (American National Standards Institute), local standards, or other. The broker checks which standard was used for measurement, the date of measurement, and the square footage. Most often, an exterior measurement of heated spaces determines the square footage. The local MLS system often defines local standards for what should be included in the square-footage measurement.

The listing broker may choose to use the second section, which lists “other source of measurement.” This section gives a list of typical choices for how the measurements were obtained: appraisals, building plans, assessor’s records, or other. The broker checks the source of measurement that was used, and lists the date of the document and the square footage. This form allows a buyer to know how the square footage of the property was determined.

The Square Footage Disclosure form further states that the square footage amount is to be used only for marketing and not for loan valuation or other purposes. It also notifies the buyer that if there is a question or concern about the square footage, the buyer should have the property measured. The buyer has until the inspection objection deadline to complete any investigations or measurements. If the buyer fails to notify the seller before this deadline, any contingency over square footage will be dropped.

Brokers should notice any obvious mistake or mismeasurements and notify all of the parties.

## **Seller’s Property Disclosure**

The seller may use two approved forms for disclosure: one for residential property only and the other for all types of property. The Seller’s Property Disclosure form lists most of the issues that might be of concern on the property and gives the seller four options: yes, no, do not know, or N/A (not applicable). There is also a place to comment, if needed. The seller is disclosing any known material defects in the property to all parties, including the listing broker, through this form. The broker should not complete the form for the seller but may review the form’s expectations with the seller.

By law, sellers are not required to complete the form but must provide a written disclosure of all the property’s material defects. The seller does not have to use the Seller’s Property Disclosure form to provide this written disclosure. However, the Contract to Buy and Sell Real Estate requests this disclosure form and gives the seller a deadline for supplying it to the buyer, if the seller or listing broker has not already provided the form. This means that if the seller is not going to provide the form, then the Contract to Buy and Sell Real Estate will need to be countered to remove the request.

## **Source of Water Addendum to Contract to Buy and Sell Real Estate**

The seller of residential property must list the source of potable (drinkable) water for the property. The seller may use either the Seller’s Property Disclosure or the Source of Water Addendum to Contract to Buy and Sell Real Estate to meet this requirement. The purpose of the form is to give the buyer notice that an important part of due diligence for the purchase of residential property is to verify that the property has a long-term source of water. The form lists the source of potable (drinking) water by checking the box for a well (along with the well’s permit number) or the water provider. If neither is checked, the source of water for the property is described in the space provided. This information helps the buyer determine whether there is a long-term source of water. The seller is obligated to disclose the source of water, but not to verify that the source of water is sufficient.

## **Closing Instructions**

The Closing Instructions form appoints a closing company to conduct the closing. It is a three-party contract between the seller, the buyer, and the closing company, which is typically part of the title insurance company. The closing company agrees to prepare the closing documents,

including settlement statements, except any “legal” documents. The title company is responsible for any legal documents, which is addressed later in the form. The form establishes how the seller will receive the net proceeds, the fee charged for closing, and other items the company will provide. If the closing company is holding the earnest money, the form spells out obligations for returning the funds or settling disputes regarding earnest money.

The second part of the form is almost like a separate form. It appoints the closing company to act as a scrivener for the listing broker.

## Counterproposal

A party, typically the seller, who wants to respond to an offer with different terms or requirements uses the Counterproposal form. Any counterproposal terminates the original offer and creates a new one. When the counterproposal is attached to the Contract to Buy and Sell Real Estate, the seller signs the counterproposal instead of the contract. The form can use both the dates and deadlines and purchase price and terms tables from the Contract to Buy and Sell Real Estate, or delete them if they are not needed. This deletion follows the Commission rules, so the heading of the table would note “Omitted” next to it.

The seller gives the buyer a new acceptance date and time. If the buyer agrees to the suggested changes and signs the Counterproposal, the property will have moved from the offer to contract stage upon notice to the seller of the acceptance. In many instances, because the parties continue to negotiate, it is incumbent upon both brokers to ensure that the final contract is in writing and clear to all parties. Often, it is easier to incorporate the changes into a new Contract to Buy and Sell Real Estate to ensure that all the agreed-upon items have been accounted for.

## Post-Closing Occupancy Agreement

When the seller is staying in the property for up to 60 days after closing, this document establishes responsibility for repairs, utilities, and maintaining insurance coverage (both property and renters). It determines the buyer’s right to enter the property after closing while the seller is a tenant. The contract also sets the rent rate, security deposit, and what happens if the seller fails to vacate as agreed. Brokers should recommend the use of this contract any time the seller will occupy the property after closing, so both the seller and the buyer are covered in case the seller damages or fails to vacate the property.

## Inspection Objection and Resolution Forms

Upon completion of the property inspection, buyers have three choices: terminate the contract, ask the seller to make repairs, or remove the inspection contingency. The buyer is not required to have the property inspected in order to terminate under this contingency. Per the Contract to Buy and Sell Real Estate, the buyer may “in buyer’s sole subjective discretion” decide to terminate any time prior to the inspection objection deadline. If the buyer finds unsatisfactory conditions, the buyer and the buyer’s broker use the Inspection Objection form to ask the seller to satisfy the conditions. Often, finding a final resolution to inspection issues requires back-and-forth negotiations. Once the buyer and the seller reach a final agreement, they use the Inspection Resolution form to document in writing what they decided. The Inspection Objection and Inspection Resolution deadlines in the Contract to Buy and Sell Real Estate are the dates by which the buyer and the seller must reach resolution. If the buyer does nothing before the objection deadline, the contingency terminates and the

contract moves forward. Typically, the buyer has an inspection conducted and asks for the seller to correct any issues that are found prior to the inspection objection deadline using the Inspection Objection form. The parties have until the resolution deadline to reach an agreement. If an agreement is not reached and the buyer does not withdraw the request, the contract terminates at midnight on the resolution deadline.

### **Agreement to Amend/Extend Contract**

Once the property enters the executory phase (under contract), any changes to the purchase contract must be approved by both the seller and the buyer, put into writing, and signed. In Colorado, the Agreement to Amend/Extend Contract is the approved form to modify the Contract to Buy and Sell Real Estate. The dates and deadlines table is reproduced and may be omitted if not needed (as it is in the Counterproposal).

The form only modifies certain items, such as the closing date. Other dates not noted or changed will remain the same. Most of the contingencies in the Contract to Buy and Sell Real Estate are negative consent, which means that the contingency will terminate if a written response is not received prior to the contingency deadline. It is important for the broker to complete the Agreement to Amend/Extend Contract before the date needs an extension, or the buyer (or in some cases, the seller) risks breaching the contract.

### **Listing Contract Amendment**

This approved form modifies the broker's employment contracts with the seller, buyer, landlord, or tenant. The broker checks which form is being modified within the Listing Contract Amendment and lists the changes. This form is frequently used to extend the contract termination date or change the sales price.

### **Notice to Terminate**

If the Contract to Buy and Sell Real Estate needs to be terminated, this approved form meets the requirement for written notice as defined in the contract. Both the buyer and seller have a list of standard items typical in a termination (e.g., the buyer's inability to obtain a loan or the seller not approving of the buyer's credit on a seller-carry loan). This form must be used any time a contract is being terminated.

### **Licensee Buy-Out Addendum to Contract to Buy and Sell Real Estate**

When a property being purchased is listed by a brokerage firm or broker, the broker or brokerage firm has an advantage over the unlicensed seller. The purpose of the Licensee Buy-Out Addendum to the Contract to Buy and Sell Real Estate form is to remove some of these advantages. The form is used with the Contract to Buy and Sell Real Estate, and the broker or firm typically also has an exclusive right-to-sell listing.

The buy-out form requires licensees to confirm that they are licensed and have enough resources to complete the transaction. In addition, they must notify the seller that the broker or firm may make a profit on resale but would also be obligated to pay any loss or expense after closing. The seller will have no obligations for expenses or losses to the brokerage firm or broker after the closing. The seller pays no commission if the buyout closes. Additionally, the form removes the appraisal provision because the broker or brokerage is responsible for

valuation. The addendum also creates a specific performance contract if the buyer defaults, and because the buyer is the broker, the requirement for notice is removed. The seller may terminate the purchase contract at any time by written notice to the broker or brokerage firm. The seller would reimburse out-of-pocket expenses to the firm or broker upon termination. Finally, the broker must present all offers until closing, and the seller may accept any of them. Commission rules further describe the use of the Licensee Buy-Out Addendum.

## **Short Sale Addendum**

Short sales use the two addenda that go with the Exclusive Right-to-Sell Listing Contract and the Contract to Buy and Sell Real Estate. These addenda are used when the seller's debt against the property (i.e., mortgage liens) is greater than the market value of the property. The listing contract informs the seller that foreclosure assistance is available and that a short sale may not be the seller's best option. Also, it states that even if the lender allows the sale, the lender may still have the right to collect any deficiency. The form also gives the seller the required warnings regarding mortgage assistance.

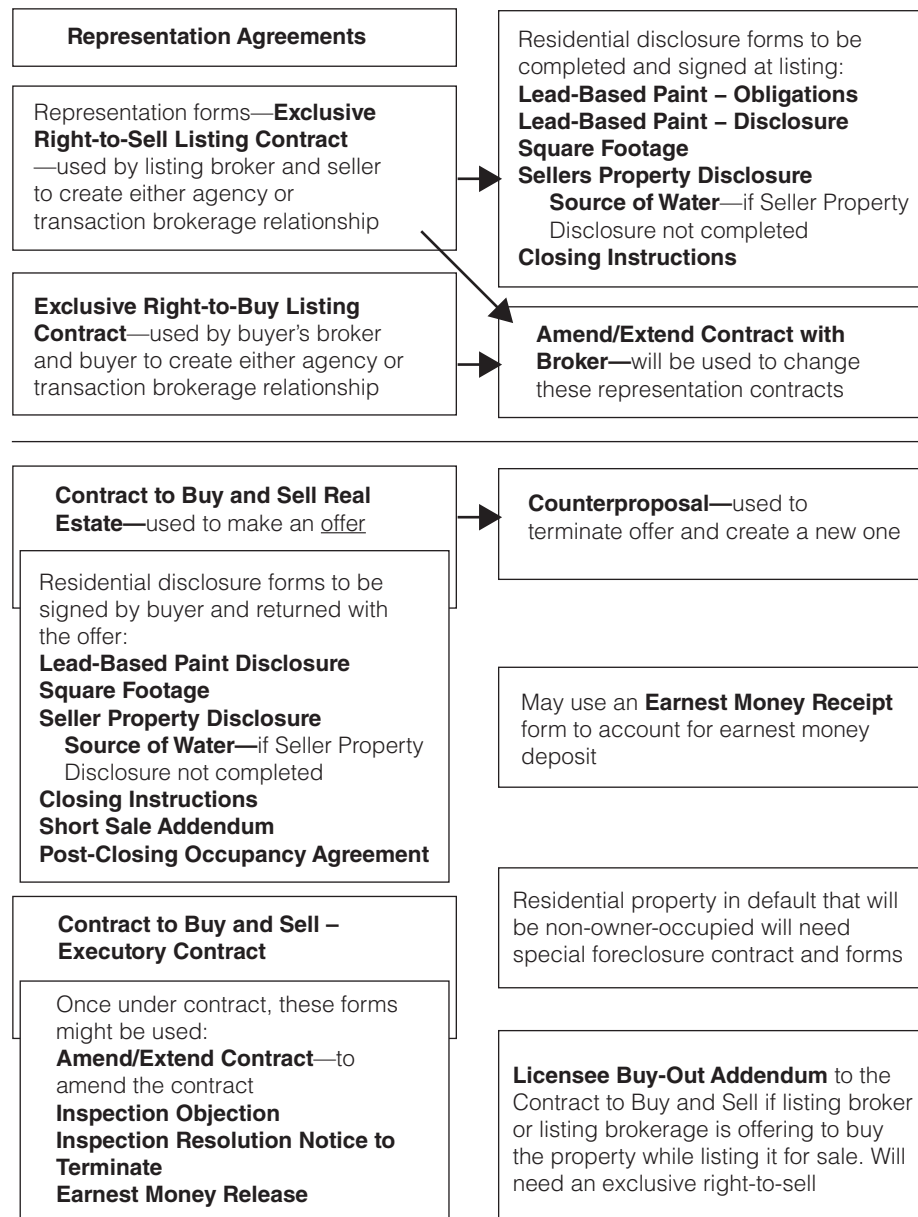
When the addendum is used with the Contract to Buy and Sell Real Estate, typically, a broker has listed the property. Once the seller/broker receives an offer, the bank must agree to its terms as well, because the purchase price will not clear any liens against the property. This addendum makes sure both the buyer and the seller are fully aware of the issues in this type of sale.

## **Statutory Power of Attorney**

If a licensee is becoming an attorney-in-fact for a member of the public, the licensee must use the approved Colorado Statutory Power of Attorney for Property form.

## **The Real Property Transfer Declaration (TD-1000)**

The Real Property Transfer Declaration (TD-1000) is a state-required form that informs the county assessor of what occurred when a property was sold and is used to "help ensure fair and uniform assessments for all property for property tax purposes." It is typically completed at the closing table. The form is required for a recorded deed that has a documentary fee. The form does not transfer real or personal property; it simply lists the values of each at the time title is transferred.

**Figure 5.1: Review of Representation Contracts**

## MISCELLANEOUS REGULATIONS

In Colorado, several regulations impact how real estate brokers practice and how property can be bought and sold. Water rights, foreclosure of deeds of trust, and property taxes are among the issues brokers must understand to help sell or buy real estate. The Commission's requirements and rules on the supervision of broker associates, maintenance of errors and omissions (E&O) insurance, and the use of unlicensed assistants are all issues that practicing broker's must understand.



## Colorado Water Rights

Colorado water rights are complex. Colorado bases its water rights on the doctrine of prior appropriation, which gives the first person who uses water for beneficial use priority of use over other owners. Water rights in Colorado are also adjudicated or processed through the water courts, which administer and further define the right of priority. In addition, because states downstream from the headwaters of Colorado's mountains also own water rights, the water law grows more complex each year. Often, water rights issues involve irrigation rights in agricultural transactions. Furthermore, as water becomes scarce, it can cause problems in residential housing developments. Consequently, sellers of residential property must disclose the source of their water to potential buyers, who are then given notice to verify that the home has a long-term source of water. Wells are a right of use and are regulated by the state engineer. Well permit numbers should be registered, and any notice of well transfer must be sent to the office of the state engineer.

## Deeds of Trust Law and Foreclosure in Colorado

Most real estate loans in Colorado use a deed of trust to create the lien. Deeds of trust require three parties: the borrower or trustor, the lender or beneficiary, and the government office of public trustee. For financing, brokers and others (i.e., sellers for seller financing) can use three approved forms. (Large lenders typically do not use the approved form and instead use a deed of trust drafted by company attorneys.) The first is the Due on Transfer – Strict form, which has a due on sale (alienation) clause that requires payment in full when the property is sold. This deed of trust is similar to those used in conventional loans. The second form is the Due on Transfer – Creditworthy form, which has a creditworthy restriction that provides for a buyer to assume the loan with credit approval by the lender. If the buyer's credit is refused, the loan is due on transfer. This deed of trust is similar to an FHA or VA assumption. The final deed of trust is the Assumable – Not Due on Transfer form, which allows any future buyer to assume the loan without the lender's (seller's) approval of credit.

When a deed of trust is in default, it is the responsibility of the public trustee to enforce the lien for the beneficiary/lender. If the borrower is in default, the lender will notify the public trustee, who in turn will file and send a Notice for Election and Demand to the borrower, which begins the foreclosure process. In Colorado, the public trustee is the only entity with the nonjudicial right to foreclose. This means that the foreclosure procedure does not go through the courts but through the public trustee's office. Upon notice by the lender, the public trustee then sends all legal notices, advertises per the law, and holds the foreclosure sale. Colorado's law is unique in that there is no statutory redemption period that gives the borrower a time period after the foreclosure sale to pay the full payment of principal, interest, and fees to redeem the property. The state's law requires the borrower to bring back payments and fees to stop the foreclosure prior to the sale in order to redeem the property. Agricultural property owners have 215 to 230 days to stop foreclosure, and all other property owners have 110 to 115 days. The date the trustee schedules the foreclosure sale determines the range of time. Once the foreclosure sale is completed, the winning bidder receives a certificate of purchase and possession rights to the property.

A private trustee could be an attorney, family member, and so on. In Colorado, the disadvantage of using a private trustee is that the private trustee does not have nonjudicial foreclosure rights, which means that the deed of trust will be treated like a mortgage, and any foreclosure must be completed through the courts. Any seller considering using a private trustee instead of the public trustee should seek the advice of an attorney.

A broker who is helping a seller with a seller-carry loan should recommend that the seller speak to an attorney. The seller may also want to obtain a mortgagee's title policy and, depending on the amount of the lien, may want to have the buyer waive any homestead rights.

A broker selling residential property may need to meet the requirements of the Colorado Foreclosure Act. The act applies if the seller is in default and the property will be non-owner-occupied for at least one year after closing. When the act applies, brokers must use special forms. Most (but not all) of these forms are identical to the original versions of these forms, but they are in bold print. The forms include Contract to Buy and Sell Real Estate – Foreclosure, Notice of Cancellation, Seller's Authorization, Seller Warning, and Homeowner Warning Notice. The broker may find several issues in making sure all parties comply with the act and use the proper forms. Once again, brokers should recommend that all parties to the transaction seek the advice of an attorney, or obtain tax or other counsel.

Equity stripping is when a non-owner occupant takes over a foreclosed property and collects rent but does not make payments. Equity stripping is a serious crime recognized as a felony in Colorado.

## **Uniform Consumer Credit Code (UCCC) and Usury**

The UCCC protects the public in consumer credit transactions by setting maximum permissible interest rates a lender may charge. A lender who charges a higher rate commits usury, which is against the law. Colorado has two rates—one for a creditor who regularly lends money (i.e., a bank) and the other for a non-creditor (i.e., a seller providing financing). The creditor rate allows up to 21% (0.21) interest on loans over \$1,000 and up to 36% on loans for \$1,000 or less. A non-creditor may charge up to 45% (0.45) interest.

## **Dual Contracting (Dual Purchase Contracts)**

Dual contracting is a form of loan fraud in which the buyer and the seller illegally agree to write two different purchase contracts, the first with the true terms of the sale for an actual closing and the second with a higher purchase price to obtain a higher loan amount from the lender. If the property appraises at the higher contract price, the lender is defrauded into making a higher than normal loan based on the actual purchase price. This is a criminal act that may result in license discipline and criminal prosecution.

## **Adverse Possession and Prescription in Colorado**

By common law, adverse possession and easement by prescription require that the possession or use of the property be open (visible), continuous, exclusive (distinct), actual, and notorious (hostile). (Use the mnemonic OCEAN to remember these requirements.) Each state then sets the requirement for how long the possession or use must be in order for the party to seek ownership or rights of use in the property. In Colorado, the party seeking ownership or rights of use must use or occupy the property for 18 years. The period is reduced to seven years if the possession is "under color of title" (i.e., the party has reason to believe they own the property, such as a fraudulent deed) or the party pays the general property taxes for seven years.

## **Taxation of Real Property in Colorado**

Each county levies and collects real property taxes to cover the costs for a variety of services to the property. In Colorado, general property taxes are paid in arrears. Property taxes become a

lien on the property (with priority ahead of all other liens) on January 1 of the year in which they are payable. Taxes may be paid either with a payment of one-half on or before the last day of February and the remaining half payable no later than June 15, or with one payment of the entire amount by April 30.

All property taxes are delinquent by June 16. Each county treasurer holds a public auction to sell the property to satisfy the tax lien on or before the second Monday in December. The property is sold for the amount of the delinquent taxes plus interest and fees at the time of sale plus any premium a bidder chooses to offer. The property owner may redeem the property within three years of the sale by paying the taxes plus interest and fees through the time of redemption. The successful bidder receives a certificate of purchase showing the bidder's rights. If the property is not redeemed within three years, the certificate holder may apply for a treasurer's deed and receive the legal title to the property.

## **COLORADO REAL ESTATE LICENSE RULES**

### **Subdivision Developer Registration**

Colorado defines a subdivision as 20 or more lots or interests sold for residential use. If a development meets this definition, the developer may need to register with the Colorado Real Estate Commission. Registration is not the same as licensing; this is a separate responsibility of the Real Estate Commission. The purpose of the registration is to make sure that consumers with complaints against a development are able to find the proper person to file a complaint against. A subdivision, development, or planned unit development (PUD) that has been approved by a regional, county, or municipal planning authority is excluded from registration because it should be easier for consumers to find the responsible party through these entities.

A developer who is converting apartments into condominiums, time-shares, or cooperatives is a subdivision. A conversion of more than 20 units requires registration. The registration act excludes campsites and campgrounds.

### **Errors and Omissions (E&O) Insurance**

E&O insurance pays legal defense and judgments (up to policy limits) for professional mistakes and negligence. It protects the broker and the public, and it is required for all active brokers and brokerage firms, licensed corporations, and limited liability companies (LLCs). Brokers can obtain the insurance from any Commission-approved, state-contracted plan, or a private carrier. Any claims by brokers are not reported to the Real Estate Commission. However, if the broker does not meet the required renewal each year on or before December 31, it is reported to the Commission. This reporting is done to make sure all brokers and firms are in compliance, which covers the requirement for E&O insurance.

### **Employing Broker Supervision**

Employing brokers must provide supervision for all broker associates in the firm. The supervision requirements vary depending on how many years the broker associate has been licensed. Employed brokers with two or more years of active experience require a reasonable level of supervision. Employing brokers must provide all licensees with a company policy manual and assure that all licensees read and sign it. Employing brokers also must review all contracts to ensure they are correctly prepared.

Brokers with less than two years of experience should receive a high level of supervision, which should include, but is not limited to, assistance with closings, preparation of contracts, and training programs. The employing broker could direct other qualified brokers to attend closings with inexperienced brokers and be available to answer questions depending on the needs and experience of the employed broker.

## **Employee and Independent Contractor Status**

Under the supervision of an employing broker, a broker associate may be either an independent contractor or an employee. This status does not affect the supervision of the broker, but does affect the tax withholding status. Broker associates who are independent contractors must have written contracts stating that their employing brokers will not withhold income tax, Social Security, or Medicare taxes. Independent contractors pay for these individually.

If a broker associate is an employee of the company, the employing broker must withhold taxes and Social Security contributions. Other employee benefits, such as health insurance, paid vacation, and a fixed work schedule, are possible but not mandatory.

## **Real Estate Administrative Professionals (REAPs)**

Licensed assistants are covered by license law and rules. Brokers who use unlicensed assistants must make sure that the assistants do not do anything requiring a real estate license including negotiating, listing, or selling; drafting contracts or filling in legal documents; or offering opinions, advice, or interpretations. Unlicensed assistants may, under the broker's supervision, provide access to properties, distribute listing information prepared by a broker, deliver paperwork to other brokers, hold an open house, deliver paperwork to sellers or buyers (if it has been reviewed by a broker), prepare market analyses (but the broker must submit and identify the preparer), measure a property for a square-footage disclosure, and sign checks on a trust account, if authorized by the employing broker. These rules apply to any unlicensed person working for a real estate broker, such as an office manager or receptionist.

## UNIT 5 LECTURE OUTLINE

### I. ADDITIONAL FORMS

#### A. Lead-Based Paint Obligations of Seller and Lead-Based Paint Disclosures (Sales) forms

1. To meet state and federal disclosure requirements of lead-based paint hazards for the sale or lease of all residential property with a building permit dated before January 1, 1978.
  - a. The \_\_\_\_\_ (or landlord) is the party that is obligated to disclose.
  - b. The broker has a duty to inform the seller of the disclosure obligation but is not obligated to disclose.
  - c. The approved Lead-Based Paint Obligations of Seller form explains the federal requirement for any property owner.
    - Application Note: The obligations form itself is not mandatory. It assists brokers in their duty to inform sellers about this important seller obligation.
  - d. The Lead-Based Paint Disclosures (Sales) form is a Colorado-approved form that meets the federal requirements.
    - (1) \_\_\_\_\_ a disclosure that there could be lead-based paint if the property was built prior to January 1, 1978.
      - (a) Federal law places this responsibility on the seller. Even an unrepresented seller (for sale by owner) must disclose.
  - e. The lead-based paint disclosure is mandatory for residential improvements with building permits issued prior to January 1, 1978.
    - (1) Disclosure is not determined by when the improvements were completed.
  - f. Sellers disclose to the “best of their current actual knowledge” the presence or absence of lead-based paint or any other lead hazard.
    - (1) If the seller has any reports about lead contamination, the reports must be provided to potential buyers.
    - (2) The seller does not have to test for or remove any lead paint.
  - g. The buyer may \_\_\_\_\_ by checking the box.
  - h. Both brokers will sign the form to confirm that they have informed all parties.
    - (1) The seller and buyer also sign the form.
  - i. There is a separate agreement for landlords and tenants of residential rentals.

### B. Square Footage Disclosure

1. This disclosure is used to bring brokers listing residential property in compliance with the law, which requires that the listing licensee disclose the source of any square-footage measurement that is provided to sellers and potential buyers of \_\_\_\_\_ property.
  - a. The listing broker can measure the property and \_\_\_\_\_ used, \_\_\_\_\_
  - b. the listing broker can use information from reliable sources and list the source used.
    - (1) The listing broker may not use sources that the broker believes are \_\_\_\_\_.
2. Measurement is for the purpose of marketing; it may not be exact and is \_\_\_\_\_.
3. Commission rules state: “A licensee working with a buyer may rely on a representation of square footage by a listing broker; however, such licensee is responsible for indications of \_\_\_\_\_ by others” (*CREM*).
  - a. Broker associates are responsible for square-footage figures.

### C. Seller's Property Disclosure

1. This disclosure is used by the seller for the required disclosure of all material defects in the property the seller has knowledge of.
  - a. Two forms are available, one for residential and the other for all types of properties.
  - b. They are not required by law or the listing contract.
  - c. The seller may decline to provide this disclosure.
    - (1) The seller must still disclose all latent defects and adverse material facts, even if selling “as is.”
    - (2) If the broker feels that the seller has nothing to hide but simply does not want to complete the disclosure form, the broker should inform the seller that the Contract to Buy and Sell Real Estate will ask for the form and that most \_\_\_\_\_ expect it. The seller will have to use a counterproposal for all offers if they refuse to provide the disclosure form.
2. The \_\_\_\_\_, never the \_\_\_\_\_, fills out the form. It is completed to the best of the seller's current actual knowledge.
3. The seller may use this form to meet the requirement to disclose the source of water supply for residential properties.
4. The buyer is advised to verify and inspect the property for a variety of issues.

### D. Source of Water Addendum to Contract to Buy and Sell Real Estate

1. This form is used if a Seller's Property Disclosure has not been completed for a residential property. It brings the seller into compliance with the requirement to disclose the source of water to the buyer.
  - a. The seller of \_\_\_\_\_ property must list the source of potable (drinkable) water for the property. The source of potable water could be one of the following:

- (1) Well (include copy of well permit if possible)
  - (2) Water provider (include name and contact information)
  - (3) Other (neither a well nor a water provider), in which case the form would include further detail (e.g., “The source of water is: [describe in detail].”)
2. The buyer is warned to verify that there will be a long-term water supply for the property.
    - a. The seller does not make any promises about the future supply of the water and whether it’s ample for the buyer’s needs; the seller merely provides information indicating the source of the water, regardless of how much exists.

#### **E. Closing Instructions**

1. This form is used by the seller and buyer to appoint a closing company to handle the closing.
  - a. It is a three-party agreement between the seller, buyer, and closing company, which is often a title insurance company.
2. The closing company agrees to prepare all the documents for closing.
3. The seller may choose how to receive net proceeds and may choose to receive them in good funds.
  - a. The seller will pay any fees for the good funds check or transfer.
4. The closing company agrees to provide closing statements to both the buyer and seller.
  - a. The \_\_\_\_\_ for the seller and buyer are still responsible for the accuracy and completeness of the closing.
5. This form establishes that the holder of the earnest money will return the funds to the buyer within five days after receipt of a Notice to Terminate or other written request.
  - a. Defines the rights if there is a dispute and the title company is holding the earnest money
  - b. Gives notice that the closing company will submit change of ownership form or registration for water wells
    - (1) Remember that it is the buyer’s responsibility, with the seller’s assistance, to complete the notification process.
6. If the seller resides outside of Colorado, the closing entity may be required to withhold potential income tax from any profit on a sale.
  - a. Per the regulation, the \_\_\_\_\_ is responsible for collecting the tax and sending it to the state.
  - b. The closing entity can be a real estate broker, an attorney, or the closing company.
7. The buyer and seller authorize the closing company to provide copies of settlement statements and other documents to each broker that the brokers are required by law to maintain.

**F. Counterproposal**

1. This form is used when the offeree (usually the seller) wishes to make a qualified acceptance of the offer.
2. A counterproposal \_\_\_\_\_ the offer and creates a new one.
  - a. The parties change positions as follows:
    - (1) The original offeree (seller) becomes offeror of the counterproposal.
    - (2) The original offeror (buyer) becomes offeree.
  - b. The dates and deadline chart from the Contract to Buy and Sell Real Estate is replicated.
    - (1) This section allows the new offeror to propose different dates or deadlines as needed.
    - (2) The note explains that when a line is left blank or “no change” is inserted, there is no change from the original proposal.
      - (a) Example: If the seller countered the offer to change the title deadline, the only date entered on the form is that in item 2. All other dates may be left \_\_\_\_\_ or have “no change” inserted.
    - (3) If “deleted” is entered into any line, the date or deadline referenced in the original contract is deleted.
    - (4) If there are no changes in dates and deadlines, Commission rules allow for the entire table to be omitted from the form as long as the section title is retained.
      - (a) Example: DATES AND DEADLINES. OMITTED—NOT APPLICABLE
  - c. This section duplicates the purchase price and terms chart from the Contract to Buy and Sell Real Estate.
    - (1) This is to be used for possible changes in price and earnest money from the original offer. It can be deleted if inapplicable.
3. Attachments
  - a. Duplicates the section from the contract for items to be made part of the counterproposal or those that are attached but not made a part of the contract
4. Other changes
  - a. Provides space for changes in any other terms from the original proposed offer
5. Acceptance deadline
  - a. The offeree will now have a new deadline by which to respond to the offer.
  - b. The note at the bottom states that the
    - (1) party making the counterproposal does not sign the original offer, and
    - (2) counterproposal form must be attached to the original offer because it relies upon the terms of the original contract and simply lists changes.



**G. Post-Closing Occupancy Agreement**

1. This agreement is used when the seller is going to stay in the property for up to 60 days after closing.
  - a. It establishes
    - (1) who is responsible for repairs and utilities,
    - (2) who is responsible for maintaining insurance coverage (both property and renters), and
    - (3) the buyer's right to enter the property after closing while the seller is a tenant.
  - b. It also sets the rent rate, security deposit, and what is to occur if the seller fails to vacate as agreed.
2. Brokers should recommend the use of this contract any time the seller will occupy the property after closing.

**H. Inspection Objection**

1. This form is designed to carry out the inspection provision of the Contract to Buy and Sell Real Estate.
2. The buyer's inspection must be before the inspection objection deadline in the contract.
3. If the buyer finds any unsatisfactory condition, the buyer must notify the seller in writing using the form before the \_\_\_\_\_.
  - a. A buyer who finds no problems proceeds to closing with no notice to the seller. The contingency expires.
  - b. The form also allows the buyer to waive the condition and withdraw the inspection objection on or before the resolution deadline, and proceed to closing.
  - c. The buyer is notified that the lender should be alerted to the inspection issues, and failure to notify the lender may result in loan delays and could require further inspections and repairs.
    - (1) Communication with the lender should be in writing.

**I. Inspection Resolution form**

1. This approved form is used to document the \_\_\_\_\_ between the buyer and seller over any inspection issues.
  - a. It gives all the parties one final place to clearly list the resolution.
2. This form must be completed and signed on or before the inspection resolution deadline, or the contract will terminate.
3. The buyer and seller are notified that the form amends the Contract to Buy and Sell Real Estate, and a copy should be provided to the buyer's lender.
4. If any of the corrections require action after the closing, this section allows them to survive.

**J. Agreement to Amend/Extend Contract**

1. This form is approved to amend contract terms or extend dates and deadlines in the Contract to Buy and Sell Real Estate \_\_\_\_\_.
2. The form reproduces the dates and deadlines table from the contract and provides spaces for other modifications.
  - a. The form is the same as the Counterproposal in that only the dates that change are entered and all of the others can be left blank or have “no change” entered.
  - b. If “deleted” is entered in a line, it means the date in the corresponding provision of the contract is to be deleted.
3. This form would be used to change the \_\_\_\_\_ of an executory contract.
4. Amendments or extensions must always \_\_\_\_\_ being extended.
  - a. Both parties must sign, once again, to show mutual agreement.

■ Notice the difference in the form title and content compared to the following Listing Contract Amend/Extend which modifies a listing or buyer contract.

**K. Listing Contract Amend/Extend**

1. This form is used for any change to a \_\_\_\_\_ contract when the brokerage firm is a party to the contract.
  - a. Examples of when this form is used include the following:
    - (1) A change in the listing price
    - (2) An extension of listing or buyer contract termination dates

**L. Notice to Terminate**

1. This approved form is used by the buyer or seller any time the Contract to Buy and Sell Real Estate is terminated per one of the contract contingencies.
  - a. Meets the contract requirement for written notice
2. The document lists the different contract contingencies that require notice.
  - a. The buyer or seller checks the box that applies.
  - b. The other box allows for other reasons for termination to be spelled out.

**M. Licensee Buy-Out Addendum to Contract to Buy and Sell Real Estate**

1. This addendum brings brokers into compliance with Commission rules.
  - a. The position statement describes the use of the Licensee Buy-Out Addendum, which is attached and made part of the Contract to Buy and Sell Real Estate.
  - b. This addendum will be subject to the Foreclosure Property Addendum, if applicable.

2. Use the Licensee Buy-Out Addendum when one of the following apply:
  - a. The broker/brokerage firm will continue to market the property under an existing listing while the offer is in effect.
  - b. The licensee's offer is a guaranteed buy-out.
  - c. The broker is buying the property to facilitate another sale in which the broker will receive a commission.
3. This addendum is used only by the
  - a. \_\_\_\_\_, or
  - b. \_\_\_\_\_ of the listing firm.
4. This addendum is not used
  - a. by any other associate of the listing firm or by any other broker in a different firm, or
  - b. when a broker makes a personal purchase of a property not listed by the broker.
5. The broker should disclose the broker's \_\_\_\_\_ in buying the property prior to listing it.
  - a. The addendum makes the contract very \_\_\_\_\_.
  - b. It requires licensees to confirm that they
    - (1) are licensed and, as buyers, have enough resources to complete the transaction and will notify the seller if there is a change,
    - (2) may make a profit on resale, and
    - (3) will be obligated to pay any loss or expense after closing.
  - c. The addendum removes the appraisal provision (licensee is responsible for valuation).
6. This addendum creates a specific performance contract if the buyer (licensee) defaults.
7. The seller may terminate at any time by written notice to the broker or brokerage firm.
  - a. The seller would reimburse out-of-pocket expenses to the licensee upon termination.
8. The seller will have \_\_\_\_\_ for expenses or losses after the closing.
9. The broker must present all offers until closing, and the seller may accept any of them.
  - a. The seller \_\_\_\_\_ if the buy-out closes.
10. Because the buyer is the broker, the requirement for notice is removed.
11. The listing brokerage firm is only responsible if the company broker (employing broker) \_\_\_\_\_ at the bottom.

**N. Short Sale Addenda**

1. These two addenda define the terms of a short sale for the seller and buyer.
2. Listing addendum
  - a. This addendum describes and defines that a short sale is when the purchase price will not pay off the seller's full lien amount at closing.
  - b. It notifies the seller that even if the lender accepts the short sale, the seller may still be held liable for the balance due to the lender.
  - c. It alerts the seller of the adverse consequences of a short sale and recommends that the seller seek the counsel of attorneys, accountants, and foreclosure experts.
3. Contract to Buy and Sell Real Estate addendum
  - a. This addendum notifies the buyer of various issues of short sales and that the offer may not be accepted by the lender.
  - b. It sets the conditions that both the seller and buyer agree to in the sale and sets the date and terms for submission of the offer to the lender.
  - c. It reminds the parties that an amend/extend contract form will be needed to change any of the terms.

**O. Statutory Power of Attorney**

1. This form must be used any time a broker is becoming an attorney-in-fact.

**P. Real Property Transfer Declaration (TD-1000)**

1. To bring all parties at the closing in compliance with the state statute to “help \_\_\_\_\_ assessments for all property for property tax purposes”
  - a. This form is required by state statute and goes to the county assessor.
2. This form does not transfer \_\_\_\_\_.

**II. MISCELLANEOUS REGULATIONS****A. Colorado water rights**

1. Water rights are a real property interest, conveyed by deed with a separate legal description.
  - a. Water rights in Colorado are determined through adjudication, which means through the Colorado water court.
  - b. Water rights in Colorado are \_\_\_\_\_—they do not automatically “run with the land”—but must be specifically transferred by deed.
  - c. These rights come from the \_\_\_\_\_—whoever uses the water for the first \_\_\_\_\_ use has senior rights (priority).

- d. In Colorado, water rights are most often an issue in agricultural transactions and are often tied to \_\_\_\_\_.
  - e. In recent years, many farmers and ranchers have sold water rights separate from their land. Water values often far exceed the value of some marginal agricultural operations.
2. The broker should recommend that the seller seek the advice of a water law attorney whenever water rights are involved.

## **B. Well permits**

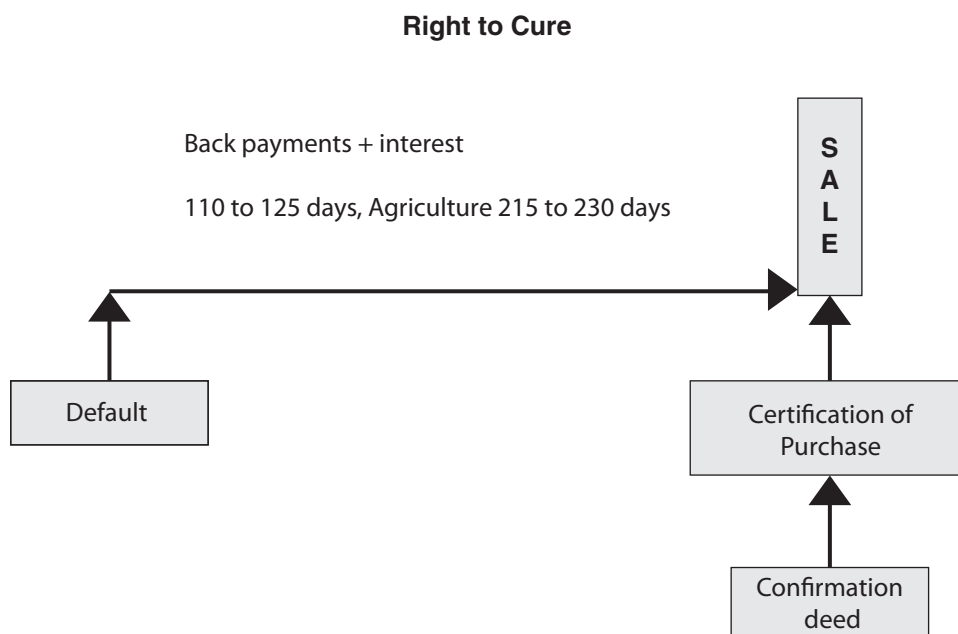
1. The \_\_\_\_\_ issues well permits to allow a property owner to drill or maintain a well.
2. A well permit \_\_\_\_\_ represent an actual water right; it is a right of use.
3. The law presumes the amount of water used by a residence does not interfere with adjudicated water rights.
4. Well permits must be transferred (by well permit number) from the seller to the buyer of the property in a report to the state engineer. The seller agrees to assist the buyer with the necessary information in the contract.
5. It is the buyer's responsibility to register and pay the fees for any well that has not previously been registered.

## **C. Deeds of trust law and foreclosure in Colorado**

1. The majority of real estate loans in Colorado use a deed of trust to create the lien, and the public trustee to foreclose, if needed.
2. Deed of trust law
  - a. The deed of trust has the following three parties:
    - (1) Trustor (the borrower)
    - (2) Public trustee (a government office)
    - (3) Beneficiary (the lender)
  - b. The public trustee has the power to enforce the lien for the beneficiary/lender. The \_\_\_\_\_ is the only entity with the \_\_\_\_\_ right to foreclose.
  - c. According to Colorado law, a deed of trust to a \_\_\_\_\_ is deemed to be a mortgage and can be foreclosed only by \_\_\_\_\_.
  - d. In Colorado, if the borrower defaults on the loan, the public trustee will exercise the power of sale based on notification from the beneficiary/lender.
3. Deed of trust foreclosure
  - a. The steps in a foreclosure are the following:
    - (1) The borrower defaults.

- (2) The lender files a Notice of Election and Demand with the public trustee. The public trustee \_\_\_\_\_ the property prior to the sale.
- (3) The borrower has a right to redeem prior to the foreclosure sale, which is called the \_\_\_\_\_.
  - (a) If the loan is brought current and all fees and charges are paid during this period, the loan returns to good standing and the foreclosure stops.
  - (b) If the borrower fails to redeem during the right-to-cure period, the foreclosure sale occurs and the successful bidder at the sale (usually the lender) receives a certificate of purchase and a confirmation deed, depending on the redemption rights of secondary liens.
- (4) The length of time given to the borrower to redeem (bring the payments current) will vary depending on the type of property.
  - (a) For all properties except agricultural, the sale must be scheduled no less than \_\_\_\_\_ from the filing, but no longer than \_\_\_\_\_.
  - (b) The period for agricultural property is no less than \_\_\_\_\_ from filing, but no longer than \_\_\_\_\_.
  - (c) If the property was purchased by a lender, it must be sold on the open market.
  - (d) If the amount received at the sale is more than the lien that was foreclosed, the balance is paid to the borrower.
  - (e) If the amount received is less than the lien, the lender can receive a \_\_\_\_\_ (general lien) and pursue the borrower's other assets to satisfy the deficiency.

**Figure 5.2: Right to Cure**



**D. Colorado Foreclosure Act**

1. If the seller is in default and the residential property will be non-owner-occupied for at least one year, the act \_\_\_\_\_ apply.
2. If the broker determines that the Colorado Foreclosure Act applies, special forms must be used.
  - a. Most (but not all) of these forms are identical to their non-foreclosure versions, but they are in bold print.
  - b. The forms typically used only in a foreclosure transaction are as follows:
    - (1) Contract to Buy and Sell Real Estate—Foreclosure
      - (a) This is the residential form in bold print that meets the requirements of the act.
    - (2) Notice of Cancellation
    - (3) Seller's Authorization
    - (4) Seller Warning
    - (5) Homeowner Warning Notice
3. Foreclosure is a complicated process with a number of issues, so brokers should recommend that all parties to the transaction seek the advice of an attorney.

**E. Equity skimming**

1. A party who takes over a foreclosure and does not make payments but collects rent is guilty of *equity skimming*, which is a felony in Colorado.

**F. Uniform Consumer Credit Code (UCCC) and usury**

1. The UCCC protects the public in consumer credit transactions by setting maximum permissible interest rates a lender may charge.
  - a. Charging a higher rate is \_\_\_\_\_.
2. A creditor who is regularly in the business of making loans may charge up to 21% (0.21) interest (and up to 36% on loans of \$1,000 or less).
3. A noncreditor, such as a seller providing seller-carry financing, may charge up to 45% (0.45) interest.

**G. Dual contracting (dual purchase contracts)**

1. A form of loan fraud in which the buyer and seller illegally agree to write two different purchase contracts:
  - a. One with the true terms of the sale for an actual closing

b. One with a higher purchase price to present to the lender in order to get a higher loan amount

- (1) If the property appraises at the higher contract price, the lender is defrauded into making a higher-than-normal loan based on the actual purchase price. This is a criminal act that may result in license discipline, as well as criminal prosecution.

#### **H. Adverse possession and prescription in Colorado**

1. A party seeking to gain ownership by adverse possession must have occupied the property for at least 18 years.
2. The period is reduced to seven years if
  - a. possession is “under color of title” (the party has reason to believe they own the property, such as a fraudulent deed), or
  - b. the party pays the general property taxes for seven years.
3. The possession must be open, continuous, exclusive, actual, and notorious. (Remember the mnemonic OCEAN.)
4. A party seeking to gain the right to use the property (a prescriptive easement) must use the property for 18 years and would gain a \_\_\_\_\_.

#### **I. Taxation of real property in Colorado**

1. Real property taxes are levied and collected by each county to pay for a variety of services to the property.
2. Tax payment schedule
  - a. In Colorado, general property taxes are paid in arrears.
  - b. The tax becomes a lien on the property (with priority ahead of all other liens) on January 1 of the year in which it is payable.
  - c. Taxes may be paid on one of the following schedules:
    - (1) Payment of one-half on or before the \_\_\_\_\_ with the remaining half payable no later than \_\_\_\_\_
    - (2) Payment of the entire tax by \_\_\_\_\_
3. Delinquent tax sale
  - a. All taxes are delinquent as of June 16.
  - b. The county treasurer holds a public auction to sell the property to satisfy the tax lien on or before the second Monday in December.
    - (1) The property is sold for the amount of the delinquent taxes plus interest and fees at the time of sale plus any premium a bidder chooses to offer.
    - (2) The successful bidder receives a certificate of purchase showing the bidder’s rights.



- c. The property may be redeemed by the property owner within \_\_\_\_\_ of the sale by paying the taxes plus interest and fees at the time of redemption.
- (1) If the property is not redeemed, the certificate holder may apply for a treasurer's deed and receive legal title to the property.

### III. COLORADO REAL ESTATE LICENSE RULES

#### A. Subdivision developer registration

- 1. A subdivision is defined as \_\_\_\_\_ or interests \_\_\_\_\_ use.
- 2. Converting apartments into condominiums, time-shares, or cooperatives is a subdivision. A 20-plus unit conversion would require registration.
- 3. Registration is not the same as licensing—this is a separate responsibility of the Real Estate Commission.
- 4. \_\_\_\_\_ are excluded from the registration act.
- 5. A planned unit development (also called a \_\_\_\_\_), or any subdivision that has been approved by a regional, county, or municipal planning authority, is excluded from registration.

#### B. Employing broker supervision

- 1. Employing brokers must provide a reasonable level of supervision to employed brokers with two or more years of active experience.
  - a. A \_\_\_\_\_ of supervision includes
    - (1) providing a company policy manual and ensuring that all licensees read it and sign that they have read it, and
    - (2) \_\_\_\_\_ prepared by every broker to assure that they are correctly prepared.
- 2. The employing broker is also responsible for a high level of supervision for employed brokers with less than two years of active experience.
  - a. A \_\_\_\_\_ of supervision includes the following:
    - (1) Specific training on company policies
    - (2) Close supervision and assistance with closings including attending closings, assigning other qualified brokers to attend closings with the inexperienced broker, and being available to answer questions depending on the needs and experience of the employed broker

#### C. Employee and independent contractor status

- 1. A broker associate, under the supervision of an employing broker, may be either an independent contractor or an employee for federal income tax purposes.
  - a. This status does not affect the supervision of the broker, it only the tax \_\_\_\_\_.

2. If a broker associate is an independent contractor, the broker associate \_\_\_\_\_ that
  - a. the employing broker will not withhold income tax, Social Security taxes, or Medicare taxes. The independent contractor will pay for these individually.
3. If a broker associate is an employee of the company,
  - a. the employing broker \_\_\_\_\_ taxes and Social Security contributions; and
  - b. the broker associate may receive other employee benefits, such as health insurance, paid vacation, and a fixed work schedule, but these are not mandatory.

**D. Errors and omissions (E&O) insurance**

1. E&O insurance protects the broker and the public.
2. It is required for all \_\_\_\_\_ and brokerage firms.
3. It is required for all \_\_\_\_\_ corporations or limited liability companies (LLC).
4. It is provided by any approved state-contracted plan or private carrier.
5. This insurance pays legal defense and judgments (up to policy limits) for professional mistakes and negligence.
6. Claims by brokers are not reported to the Real Estate Commission.
7. E&O insurance must be \_\_\_\_\_ on or before December 31.

**E. Real Estate Administrative Professionals (REAPs)**

1. Licensed assistants are covered by license law and rules.
2. Unlicensed assistants may not
  - a. negotiate, list, or sell;
  - b. draft contracts or fill in legal documents; or
  - c. offer opinions, advice, or interpretations.
3. Unlicensed assistants may
  - a. provide access to properties
    - (1) but may not show a property without the listing broker or seller's permission;
  - b. distribute listing information prepared by a broker;
  - c. deliver paperwork to other brokers;
  - d. hold an open house;

- e. deliver paperwork to sellers or buyers (if it has been reviewed by a broker);
  - f. prepare market analyses (but the broker must submit and identify the preparer);
  - g. measure a property for a square- footage disclosure; and
  - h. \_\_\_\_\_ on a trust account, if authorized by the employing broker.
4. These rules apply to any unlicensed person working for a real estate broker, such as a(n) \_\_\_\_\_, receptionist, assistant, bookkeeper, transaction coordinator, or onsite manager, to name a few.



# UNIT 6

## Fair Housing, Property Management, Leasing, and the Law

### UNIT 6 OVERVIEW

#### **Fair Housing in Colorado**

- Comparison of federal and Colorado fair housing law
  - Fair housing in property management
- Prohibited actions in fair housing law

#### **Property Management in Colorado**

- Property management licensing
- Right-to-lease contracts
- The management agreement
- Americans with Disabilities Act
- Security deposits
- Record keeping
- Homeowners association management
- Leasing review

#### **License Law**

- Purpose of the law
- Licensing requirements
- License disclosure

- License renewal and education requirements
- Trade names
- Investigations, hearings, and penalties
- Competency
- Seller-assisted down payments
- Business opportunity brokerage
- Real estate securities
- Real estate options

### **Appraiser Licensing**

- Colorado license law for appraisers

## **COLORADO FAIR HOUSING LAW**

Colorado fair housing law is older than the federal law. It includes residential and commercial property. In the rental or sale of property, Colorado adds protection for marital status and sexual orientation in addition to the federally-protected classes of familial status, race, sex, handicap, color, religion, and national origin. (Remember the mnemonic device FReSH CoRN.) The Colorado exemptions are also more restrictive than the federal law.

## **PROPERTY MANAGEMENT**

Property management is an area of specialty practice in real estate. A broker associate may not manage property without the involvement and permission of the firm's employing broker. The employing broker must establish the trust accounts, maintain records, and sign the management agreement with the property owner.

In Colorado, the landlord must return tenants' security deposits within 30 days, unless the lease has an extension. In no case can the deposit be held for more than 60 days. Within this time frame, landlords must return the deposit or send notification to the tenant and detail why they are holding the funds. Landlords may not withhold funds for normal wear and tear.

## **COLORADO LICENSE LAW**

Colorado license law and the Colorado Real Estate Commission exist to protect the public. The Commission protects the public by recommending legislation and promulgating rules, regulations, and position statements to guide real estate brokers.

The Commission has processes for giving licenses, as well as taking them if licensees violate a law or rule. The Commission is the only entity that can revoke a license. Individuals are required to possess a real estate license to sell business opportunities if the sale includes any real property or transfer of lease rights. Selling real estate options requires a real estate license, while selling securities requires a securities license.

### **Competency**

Colorado license law states that brokers are expected to practice real estate only when they are fully competent to represent the consumer in the transaction. Brokers may become competent through education, completing transactions with another competent broker or mentor, or a combination of both.

If the licensee does not have the necessary competency (i.e., experience, training, and/or knowledge) to consummate the terms of the contract, the licensee should either decline to provide brokerage services or gain the competency prior to providing the brokerage services.

Upon receiving a real estate license, license law requires broker associates to work for two years under an employing broker to gain experience in the area of practice in which they intend to work. A broker who wishes to change from one specialty to another, such as moving from residential to commercial or from city property to farm and ranch, would be expected to gain competency prior to completing a transaction.

# UNIT 6 LECTURE OUTLINE

## I. FAIR HOUSING IN COLORADO

### A. Colorado fair housing law

- 1. Colorado fair housing law is older than the federal law.
- 2. Under federal fair housing law, the most stringent law will apply. (State is more strict than federal.)
- 3. The law includes all the federally protected classes plus marital status and sexual orientation.
- 4. Colorado law applies to all real estate, both residential and commercial.
- 5. The Colorado Civil Rights Commission enforces the law. Complaints may be filed with the Civil Rights Commission up to \_\_\_\_\_ or in state court up to \_\_\_\_\_ following the alleged discrimination.

Figure 6.1: Colorado Fair Housing Law

Fair Housing Act Comparison	
FEDERAL	COLORADO
Protected Classes	
Prohibit discrimination based on	
F _____	Same
R _____	Same
equal	
S _____	Same
H _____	Same (called disability)
C _____	Same
opportunity	
R _____	Same (also creed)
N _____	Same (also ancestry)
	adds _____
	and _____
Property Included	
Residential only	_____ and residential
Enforced By	
HUD and federal courts	Colorado _____ Commission and state courts

### B. Illegal practices under the fair housing law

- 1. The law defines unfair housing practices as illegal because they result in a protected group being treated differently from others in society.
- 2. This different and unfair treatment is referred to as *disparate treatment*. The following illegal practices (federal violations) are also violations of Colorado fair housing law:



- a. *Steering*: A broker selects properties to show or sell based on the protected-class characteristics of a buyer.
- b. *Blockbusting and panic peddling*: A broker attempts to induce owners in a neighborhood to sell by suggesting the property values are about to drop due to changes in the racial or ethnic makeup of the neighborhood.
- c. *Redlining*: A lender refuses to loan to individuals in a particular area based on the crime rate or racial, ethnic, or nationality composition of the area.

### C. Fair housing compliance and advertising

1. Brokers must comply with fair housing requirements when advertising. Ads excluding protected classes are unacceptable.
2. It is best to describe the property rather than who should live in it (property vs. people). Consider the following examples for a studio apartment ad:
  - a. Poor: “Sunny unit perfect for young adult or single professional.”
  - b. Better: “Sunny unit for one or maybe two.”
  - c. Best: “Sunny studio apt. close to the city.”

### D. Fair housing complaints

1. If a person believes she has been illegally discriminated against, the Colorado Fair Housing Act provides the following:
  - a. She may file a complaint with the Colorado Civil Rights Commission.
  - b. This complaint must be filed within one year after the alleged unfair housing practice occurs.
  - c. The Civil Rights Commission will first seek to voluntarily adjust the complaint.
    - (1) If a broker brings an offer to a seller who rejects it because the seller will not sell to a protected class (such as a mother with children), the broker could file a complaint against the seller and request the broker’s commission as damages.

### E. Fair housing in property management

1. Colorado fair housing includes all real property, not just residential.
2. Disabled tenants are protected under the law.
  - a. A *disability* is defined as any impairment that limits a major life activity.
  - b. The property manager must allow \_\_\_\_\_ without requiring the tenant to ask for permission.
  - c. The tenant would be expected to pay for the modifications.
  - d. Tenants may be required to remove modifications and repair damage when they leave.

- e. Property managers must make “reasonable accommodations” in rules or policies to accommodate the handicapped.
  - (1) The manager must also allow guide or service animals even if they have a “no pets” policy. The manager may not charge an extra damage deposit for the service animal.
  - (2) Per HUD: “Assistance animals are not pets. They are animals that do work, perform tasks, assist, and/or provide therapeutic emotional support for individuals with disabilities.”
  - (3) An apartment complex with “first-come, first-served” parking must waive or amend its rules to permit assigned parking for a person with limited mobility.
- 3. Tenant application and selection processes must be universal.
- 4. Failure to design units first occupied as accessible after March 13, 1991 are a violation.
  - a. This applies to properties with four or more units.
  - b. Buildings with elevators must make all units accessible.
  - c. Buildings without elevators must make ground units accessible.
  - d. Common-use areas must be accessible.

## II. PROPERTY MANAGEMENT IN COLORADO

### A. Property management licensing

- 1. A real estate license is required when doing any of the following for others
- 2. 12-10-201(6)(a) C.R.S.
  - a. Negotiating leases
  - b. Soliciting tenants on behalf of landlords
  - c. Representing tenants seeking space to lease
- 3. On-site managers of apartment complexes are exempt from licensing as long as they
  - a. report to the owner or a licensed broker who reports to the owner;
  - b. are salaried (rent value counts as salary); and
  - c. do not negotiate the terms of leases.

### B. Obligations of property managers

- 1. The property manager should select \_\_\_\_\_ tenants.
- 2. If managing industrial property, the manager should be concerned about any \_\_\_\_\_.

**C. The management agreement**

1. No approved form exists for property management contracts; each assignment is unique.
  - a. The management agreement defines the relationship between the owner and the property manager.
  - b. The employing broker signs the management contract for the firm.
    - (1) \_\_\_\_\_ may not manage property unless the employing broker signs the contract and manages any trust accounts.
2. If there is no mention of who is going to hold the security deposits, the employing broker should hold them. If the deposits will go to the owner, the broker must notify the tenant of the transfer.

**D. Americans with Disabilities Act**

1. This act is not a fair housing law; it applies to all properties.
2. Under the act, places of public accommodation must be accessible to the degree that they are “readily achievable.”
3. The removal of physical barriers and provision of auxiliary aids may be the responsibility of either the landlord or tenant. This must be negotiated with the lease.

**E. Security deposits**

1. The landlord must return deposits \_\_\_\_\_ after termination of the lease or surrender and acceptance of possession.
  - a. The lease may specify a longer period up to 60 days.
2. The landlord must specify in writing the amounts withheld for damage to the property (within the same time period).
3. The landlord may not withhold funds for “normal wear and tear.”
  - a. Normal wear and tear is the natural physical deterioration that occurs with the use of property and the passage of time. It does not include the effects of abuse or accidental damage.
4. The landlord could be liable \_\_\_\_\_ the amount of deposits wrongfully withheld.

**F. Record keeping**

1. The employing broker is responsible for maintaining management and financial records.
  - a. All records must be kept for a minimum of \_\_\_\_\_.
2. A property manager has \_\_\_\_\_ to deposit rents (see Commission rules, CREM) (three business days for earnest money).

**G. Homeowners association (HOA) management**

1. If the management of an HOA is changed, the previous broker/manager must return all \_\_\_\_\_ records to the association without charge.

**H. Leasing review: leasehold estates (tenancies)**

1. Estate for years
  - a. \_\_\_\_\_
  - b. \_\_\_\_\_ for termination
  - c. Does not terminate on death of either party
2. Estate from period to period (periodic tenancy)
  - a. Automatically renewing until one party gives notice to quit
  - b. Time of notice is by state law or in the lease
  - c. Month to month requires ten days' minimum notice
  - d. Does not terminate upon death of either party
3. Estate (tenancy) at will
  - a. No specific term or renewal period
  - b. Permission of the landlord
  - c. \_\_\_\_\_ minimum notice to quit
4. Estate at sufferance (holdover tenancy)
  - a. Tenant stays after termination
  - b. Landlord has option to accept renewal
  - c. No notice to quit—the tenant stays illegally

**III. LICENSE LAW****A. Purpose of the law**

1. License law \_\_\_\_\_ of the State of Colorado (see Commission rules, CREM).

**B. Licensing requirements**

1. A real estate license is required for anyone doing any of the following for a fee for others:
  - a. Selling, buying, renting, or leasing real estate
  - b. Offering to buy, sell, rent, or lease real estate

- c. Negotiating the sale, rental, or exchange of real estate
  - d. Listing, offering, or attempting to list real property for sale, rent, lease, or exchange
  - e. Auctioning real estate for others
  - f. Selling real estate options
2. Colorado issues only broker licenses to new applicants.
- Colorado is a single-license state. The state issues only *broker* licenses.
3. To obtain a Colorado broker license, all of the following are required:
- a. Complete 168 hours of prelicensing education
  - b. Pass the state and national exams
  - c. Submit fingerprints and background check
  - d. Submit an application to the Colorado Real Estate Commission (CREC)
4. The applicant must also be at least \_\_\_\_\_.

### C. Exemptions from licensing

1. The following are exempt from licensing:
- a. Attorneys-in-fact acting without compensation
  - b. Public officials in the conduct of duties
  - c. Anyone acting on their own behalf
  - d. Attorneys-at-law representing clients
- (1) Must be licensed if acting as a broker

### D. Applying for a real estate license

1. License exam scores are valid for one year.
- a. Once the applicant has passed both the national and state portions of the exam, the one-year period begins.
2. The Commission may require proof of an applicant's "truthfulness, honesty, and good moral character."
- a. Normally, the employing broker's statement on the application provides this proof.
3. A background check is part of the licensing process. Fingerprints are submitted to the Colorado Bureau of Investigation for a state and national criminal history check.
- a. Any applicant caught falsifying information may be fined and denied a license (CREM).

**E. License disclosure**

1. All active brokers must disclose that they have a Colorado broker's license. This disclosure should be done \_\_\_\_\_ any negotiations with consumers.
2. Any contract that brokers enter into must have the disclosure in writing, typically in additional provisions.
  - a. Example: "Sarah Jones is an active, licensed Colorado real estate broker."
3. Upon meeting or dealing with an unrepresented consumer, a broker should disclose his license status if he has an ownership interest in a property and is selling it or is interested in buying a property (i.e., FSBO).
  - a. Example: Broker Sarah sees an FSBO open house in an area in which she is interested. Upon entering the home, Sarah should give the owner her name and disclose that she is a broker. The same would be true if Sarah were selling her own home.

**F. License renewal**

1. Once received, a broker's license will expire three years after it is issued on December 31.

**G. License renewal education requirements**

1. Brokers must complete \_\_\_\_\_ of continuing education during the three-year period prior to renewing.
2. Brokers must take three different four-hour ACU (Annual Commission Update) courses during the three-year period as part of the requirement (one per calendar year).
3. The remaining hours of continuing education can be taken as electives (on any topic the broker chooses), but each course must comply with the topics permitted by Colorado statute and the Real Estate Commission.
  - a. The NAR (National Association of REALTORS®) ethics class would be acceptable, but topics on personal marketing, company sales, orientation meetings, or exam prep are not.
  - b. The broker is responsible for verifying that the provider and the course have been approved by the Commission.
    - (1) The approval list is on the Commission's website.
4. Licensees are responsible for keeping their certificates of completion from each course provider.
5. Alternatives to the continuing education requirement include the following:
  - a. Brokers may take and \_\_\_\_\_ of the licensing exam to satisfy the entire 24-hour continuing education requirement. The \_\_\_\_\_ is not required.
  - b. Brokers may take the 24-hour Brokerage Reactivation course; this course may only be taken every other license cycle for continuing education credit.

6. If a broker fails to pay the renewal fee on or before the expiration, there is a 31-day grace period; the broker will need to pay only the renewal fee. The broker must have met the \_\_\_\_\_ prior to expiration.
  - a. After \_\_\_\_\_ and up to one year, the broker may reinstate a license by paying the renewal fee plus a reinstatement fee of half the renewal fee.
  - b. During this period, the broker's license is considered to be active, but the broker may not practice real estate until the license fee is paid.
  - c. After a year, but within three years, the broker can renew the license by paying the renewal fee plus a reinstatement fee equal to the renewal fee.

#### **H. Place of business**

1. All active brokers must maintain a place of business open to the public.
2. Licensees working for an employing broker use the brokerage firm's address to meet this requirement.

#### **I. Transfer and inactive license status**

1. The Real Estate Commission must be able to locate all licensees.
  - a. Licensees are tracked through their employing brokers. An employing broker is required to keep the Commission informed of any changes.
2. The Commission must be notified when any of the following occur:
  - a. There is a change of business location by the firm
    - (1) When a change takes place without notifying the Commission, it makes the brokerage firm's license \_\_\_\_\_ along with the licenses of \_\_\_\_\_ employed broker associates.
  - b. A broker associate is changing employment to a new firm
    - (1) If a licensee leaves a brokerage firm, the licensee and the employing broker have joint responsibility to notify the Commission of the change.
3. Licensees may work for only one employing broker at a time.

#### **J. Inactive license**

1. Licensees may elect to place their license on inactive status with the Real Estate Commission.
  - a. Inactive brokers are still responsible for paying all renewal fees.
  - b. There is no requirement to complete continuing education while on inactive status.
  - c. Inactive brokers are not required to maintain an office or to have \_\_\_\_\_.
  - d. Inactive brokers may not perform real estate functions or earn a commission while on inactive status.
2. To reactivate an inactive license, licensees must complete 24 hours of continuing education and apply for a change of license status with the Commission.

**K. Nonresident broker**

1. Nonresidents of Colorado may hold an active Colorado real estate license.
2. Nonresident brokers must maintain an office in their home states but are not required to have Colorado offices.
3. If a nonresident broker holds money for a transaction in Colorado, the funds must be held in a Colorado bank account. With the agreement of the parties, a Colorado title insurance company or another escrow account could also hold the money.

**L. Referral fees to out-of-state brokers**

1. Referral fees to out-of-state brokers must also be paid only to those who have an office and an active license.

**M. Trade names**

1. Real estate firms use two types of trade names.
  - a. First, a unique name registered with the state
    - (1) For example: An independent firm wants to be called ABC Realty. The trade name must be registered with the Colorado Department of Revenue or the secretary of state before the firm may hold its license in that name.
    - (2) The employing broker and all licensees can do business only under the ABC Realty name.
    - (3) All advertising and property signs must clearly specify the name of the \_\_\_\_\_ as licensed with the Real Estate Commission.
  - b. Second, a brokerage firm using a “name owned by another,” such as Century 21, RE/MAX, or Metro Brokers
    - (1) The brokerage firm still must use the brokerage identity “in a conspicuous and reasonable manner calculated to attract the attention of the public.”
    - (2) In other words, the Commission would require not just “Century 21,” but “Century 21 – XYZ Realty.”
    - (3) These brokerage firms must include wording in their advertising that clearly shows that individual offices are “independently owned and operated.”
    - (4) There are \_\_\_\_\_ for the difference between the brokerage firm and the broker’s name.
2. It should be relatively easy for a consumer to identify exactly which office and licensed broker are advertising (see Commission rules, CREM).
3. \_\_\_\_\_ placed by broker associates for properties listed with the brokerage firm must include the licensed name of the brokerage firm. A broker associate can include her name and phone number, but she must identify her brokerage firm in all advertising (see Commission rules, CREM).



4. The Commission will not issue a license to an individual under a fictitious name. Licensees may not hold a license under more than one name.

■ Note: The name on your completion certificate and the name on your license should both be your legal name.

#### **N. Investigations, hearings, and penalties**

1. The Colorado Real Estate Commission may investigate any licensee's activities and, upon receiving a \_\_\_\_\_ complaint, must investigate.
2. The Colorado Real Estate Commission will \_\_\_\_\_ that the licensee answer the complaint and supply supporting documents.
3. Prior to requesting the response, the Colorado Real Estate Commission does not have subpoena power, nor would they file a lawsuit or just show up and take the records in question.
4. If the Commission's investigation finds no violation, it will dismiss the complaint.
5. If the Commission investigation finds improper activities that do not call for a hearing, the Commission may dismiss the complaint or issue a letter of admonishment reminding the licensee of the provisions of the law. A letter of admonishment is the lowest level (least serious type) of \_\_\_\_\_ the Commission can take.
6. If the investigation shows that license law may have been violated, the Commission may send the matter to a hearing before an administrative law judge.
7. If the judge finds that the "respondent" (the licensee who must respond to the complaint) has violated license law, the matter returns to the Commission to determine a penalty.
  - Investigations are conducted by the Division of Real Estate.
  - Hearings are conducted by an administrative law judge.
  - Penalties are assessed by the Real Estate Commission.
8. The Commission may
  - a. impose an administrative fine not to exceed \$2,500 for each separate offense; or
    - (1) Note: This is a fine and is not related to \_\_\_\_\_, which can only be determined by a court. Damages would be awarded to compensate an injured party; fines are penalties for breaking the law.
  - b. censure a licensee, temporarily suspend, or permanently revoke a license if the licensee is found guilty.
    - (1) The Commission may not impose any jail sentence or \_\_\_\_\_.
    - (2) Only the Commission may revoke a license.

**Figure 6.2: Commission Process**

No Hearing	Discipline After a Hearing
Dismiss	Fine up to \$2,500
Letter of admonishment	Censure
	Suspend
	Revoke

9. Discipline records are available to the public and are posted on the Commission website.
10. The Commission may audit a broker's escrow account and check the broker's records for all real estate transactions at any time.
  - a. Such routine audits do not necessarily suggest a complaint against or any wrongdoing by the broker.
  - b. The Commission is not required to notify a broker prior to an audit.
11. License law lists some of the following as specific violations that would call for disciplinary action against that person's license (12-10-217 C.R.S.):
  - a. Fraud or misrepresentation
  - b. Improper accounting for funds belonging to others
  - c. Violating the Colorado Consumer Protection Act
  - d. Commingling: mixing money belonging to others with personal or business funds of the broker
  - e. Failure to provide the purchaser and seller with a proper closing statement
  - f. Failure to adequately supervise the activities of employed licensees (in the case of an employing broker)
  - g. Accepting payment for an act that requires a real estate license from anyone except the licensee's employing broker
  - h. Demonstrating unworthiness or incompetence
12. The Real Estate Commission does not have any authority over ethics in real estate practice or \_\_\_\_\_ between brokers.
13. Brokers with an active license must notify the Commission if they are charged with a crime or violation that must be disclosed per the statute.

## **O. Competency**

1. Brokers are expected to be \_\_\_\_\_ when representing the public.
2. Competency can be gained through \_\_\_\_\_ or by completing a similar transaction with another broker.
3. Brokers who are not competent should refuse to provide service until they gain competency.

**P. Seller-assisted down payments**

1. Real estate licensees should
  - a. note all seller-paid costs in all relevant documents and in the MLS after closing,
  - b. advise buyers and sellers to consult legal and tax counsel for advice on tax consequences, and
  - c. cooperate with appraisers and lenders.
2. Title companies and the Real Estate Commission do not require this information.
3. Seller-assisted down payments are most typical in residential properties.

**Q. Business opportunity brokerage**

1. A real estate license is required if the sale includes
  - a. any interest in real property, or
  - b. the transfer of lease rights.
2. Every business opportunity listing must have a \_\_\_\_\_.

**R. Real estate securities**

1. Some real estate–related transactions are defined by law as securities transactions.
  - a. A securities license (stockbroker's license) is required to sell these types of transactions.
  - b. Both federal securities laws and state securities laws (blue sky laws) apply to the sale.
2. Examples of real estate securities
  - a. Shares in a real estate investment trust (e.g., a mutual fund investing in real estate instead of stocks)
  - b. The sale of condominium or time-share units with a developer-sponsored \_\_\_\_\_
    - (1) This requires that when owners are not using their units, they place the unit in a rental pool. The proceeds are then divided among all owners whose units were available, whether they were rented or not.

**S. Real estate options**

1. Listing and selling real estate \_\_\_\_\_ for others requires a real estate license.
  - Note: Real estate options are similar to stock options in that they set a specific price, premium, and period of time for a contract related to an underlying asset. Options can be exercised early or at the expiration date. They can also be sold to another investor.

**T. Affiliated business arrangements**

1. Any business arrangement with a title company or settlement agency must be disclosed to consumers and the Real Estate Commission (see Commission rules, CREM).
2. Brokers disclosing to consumers use a HUD-approved form.
3. Brokers disclosing to the Real Estate Commission use a state-provided form.
4. Employing brokers should supply further guidelines.

**IV. APPRAISER LICENSING****A. Colorado license law for appraisers**

1. Colorado has four categories of registration, licensing, and certification:
  - a. Ad valorem appraiser (assessor's staff only)
  - b. Licensed appraiser
  - c. Certified residential appraiser
  - d. Certified general appraiser
2. Brokers may prepare a comparative market analysis (CMA) or broker price opinion (BPO) without an appraisal license, but it requires them to disclose that they are not \_\_\_\_\_ (see Commission rules, CREM).
  - a. The rule states: "When a real estate licensee prepares a CMA or BPO for any reason other than the anticipated sale or purchase of the property, the broker must include a notice stating: "This evaluation was prepared by a licensed real estate broker and is not an appraisal. This evaluation cannot be used for the purpose of obtaining financing."

# UNIT 6 REVIEW EXAM

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1. The Licensee Buy-Out Addendum states all of the following *EXCEPT*
  - A. the buyer is a licensee and has the resources to purchase the property.
  - B. any profit or loss after closing will belong to the buyer.
  - C. the buyer may be exposed to expenses and loss.
  - D. the seller will pay commissions and cover any loss to the buyer at closing.
2. If a buyer is submitting an offer on an approved Contract to Buy and Sell Real Estate in which the seller has requested liquidated damages if the buyer is in default, which of the following must occur?
  - A. The proper language must be inserted in additional provisions.
  - B. This is the contract default, so the buyer and seller do not need to do anything.
  - C. The seller must check the appropriate box after accepting the offer.
  - D. The correct box must be checked in the Remedies section.
3. By law, which is required for a third party to sell a business opportunity that includes the real property rights?
  - A. Nothing
  - B. Business opportunity sales license
  - C. Real estate license
  - D. Options license
4. When using the Square Footage Disclosure, the broker must do all of the following to be in compliance *EXCEPT*
  - A. measure the property or hire someone to measure it.
  - B. state that the measurements are not for loan or valuation purposes.
  - C. identify the source of measurements if the measuring was not done by the broker.
  - D. use sources deemed to be reliable for residential measurements.
5. A broker who wants to change the closing date in a Contract to Buy and Sell Real Estate would
  - A. use an Agreement to Amend/Extend Contract signed by the parties.
  - B. use a Counterproposal form signed by the parties.
  - C. use a Listing Contract Amendment form signed by the parties.
  - D. write a letter, have the parties sign it, and submit it to the title company.
6. The Inspection Objection form would be used for all of the following *EXCEPT*
  - A. withdrawing the buyer's inspection objection.
  - B. extending the date of the objection deadline.
  - C. alerting the buyer to involve the lender.
  - D. requesting the seller to repair the property.
7. According to the Residential Contract to Buy and Sell Real Estate, notice to the buyer's representative is effective notice to the
  - A. buyer.
  - B. seller.
  - C. buyer only for a buyer's agent.
  - D. seller only for a seller's agent.
8. Language in the additional provisions section of the approved Contract to Buy and Sell Real Estate can include and is limited to
  - A. the broker's own exculpatory language.
  - B. location-specific language.
  - C. set clauses that the broker uses in all contracts.
  - D. conditions and terms negotiated between the buyer and seller.
9. The buyer is getting an 80% LTV. The loan amount will be determined by the
  - A. appraised value.
  - B. sales price.
  - C. higher of the sales price or appraised value.
  - D. lower of the sales price or appraised value.

10. Which document lays out the details of how the real estate closing will be handled, acts as an employment agreement with the title company, and clarifies many issues that are important to the buyer and seller?
  - A. Contract to Buy and Sell Real Estate
  - B. Closing Instructions
  - C. Earnest Money Receipt
  - D. Agreement to Amend/Extend Contract
11. If a seller has granted an unrecorded easement across the property, what will happen once the property is under contract?
  - A. It will be void when the property sells.
  - B. The seller must provide a copy to the buyer.
  - C. The seller may keep it confidential.
  - D. The buyer may decide to cancel the easement.
12. How many days is the right-to-cure period for agricultural property?
  - A. 95–100
  - B. 110–125
  - C. 215–230
  - D. 250–265
13. Which transfers automatically with the title?
  - A. Trade fixtures
  - B. Electrical fixtures
  - C. Freestanding refrigerators
  - D. Emblems
14. A seller completed a counterproposal and gave it to the buyer, but then received a better offer from another buyer. What can the seller do?
  - A. The seller may not cancel the offer and must wait for the first buyer to respond.
  - B. The listing broker should deposit the earnest money from both offers until the dispute is settled.
  - C. The buyer has until the acceptance date to respond or decline the offer and the seller may not interfere.
  - D. The seller should cancel the counterproposal before accepting the new offer.
15. A lender who forecloses on a property and sells it for less than what was owed has the right to obtain a
  - A. writ of condemnation.
  - B. lis pendens.
  - C. deficiency judgment.
  - D. default judgment.
16. In the Contract to Buy and Sell Real Estate, title insurance and settlement costs are paid
  - A. only by the seller.
  - B. by the brokers.
  - C. as part of the title insurance.
  - D. as negotiated between the parties.
17. A nonresident broker must do all of the following *EXCEPT*
  - A. keep all trust funds received in a Colorado depository.
  - B. complete all Colorado license requirements for renewal and continuing education.
  - C. be supervised by an active Colorado employing broker.
  - D. have an office in the broker's home state.
18. The first step the Commission takes after receiving a complaint about a broker associate is to
  - A. send the employing broker a suspension notice.
  - B. suspend the broker's license until the issue is heard.
  - C. issue a letter of admonishment.
  - D. investigate and ask the broker for a response to the complaint.
19. To be in compliance with continuing education requirements, which of the following should all brokers complete during each three-year license cycle?
  - A. 9 hours of ACU courses and 15 hours of electives
  - B. 12 hours of ACU courses and 8 hours of electives
  - C. 12 hours of ACU courses and 12 hours of electives
  - D. 24 hours of any approved courses the broker chooses
20. An unlicensed assistant may do all of the following *EXCEPT*
  - A. show a property with the listing broker's or seller's permission.
  - B. sign on a trust account.
  - C. make and confirm appointments for a broker.
  - D. complete and present a CMA to a seller.

21. If the buyer wants to terminate the contract prior to the inspection objection deadline, which form should the buyer use?
  - A. Notice to Terminate
  - B. Inspection Objection
  - C. Inspection Resolution
  - D. Listing Contract Amendment
22. Brokers must renew their real estate licenses every
  - A. four years on December 31.
  - B. three years by December 31.
  - C. year on December 31.
  - D. three years at the same time their E&O insurance is renewed.
23. The purpose of the Inspection Resolution form is to
  - A. list all the items the buyer wants the seller to repair.
  - B. give the buyer a list of the seller's alternate resolution.
  - C. allow the buyer to withdraw the inspection request.
  - D. finalize the agreement between the buyer and seller.
24. A broker's E&O coverage typically expires and must be renewed
  - A. by June 30 of each year.
  - B. every three years on the anniversary date.
  - C. by December 31 of each year.
  - D. by January 1 of each year.
25. The Commission could impose all of the following on a broker who is found guilty of breaking license law *EXCEPT*
  - A. a fine and suspension of license.
  - B. a \$2,500 fine and censorship of license.
  - C. a notice of the infraction on the Commission's website.
  - D. a \$2,500 fine for damages and a revocation of license.

# ANSWER KEY AND RATIONALES FOR UNIT 6

## REVIEW EXAM

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1. **D** The answer is the seller will pay commissions and cover any loss to the buyer at closing. The Licensee Buy-Out Addendum states that the seller will pay no commissions or expenses for the buyer if the contract closes.
2. **B** The answer is this is the contract default, so the buyer and seller do not need to do anything. Liquidated damages is the contract default, which means the parties do not need to make a choice.
3. **C** The answer is real estate license. A third party selling a business opportunity must have a real estate license if the sale includes any real property interests, such as the lease or sale of the real estate. The owner of the business opportunity may sell it without a license.
4. **A** The answer is measure the property or hire someone to measure it. The square footage disclosure does not require the listing broker to measure the property, but if the broker does, the method used must be stated.
5. **A** The answer is use an Agreement to Amend/Extend Contract signed by the parties. The Agreement to Amend/Extend Contract is the approved form for this purpose.
6. **B** The answer is extending the date of the objection deadline. The Inspection Objection form provides provisions for all of the options, except extending a deadline. The extension would require an Agreement to Amend/Extend Contract.
7. **A** The answer is buyer. The notice section is clear that notice to the brokerage firm working with the buyer is considered notice to the buyer. The same is true for notice to the seller.
8. **D** The answer is conditions and terms negotiated between the buyer and seller. Additional provisions must be transaction-specific and negotiated between the parties.
9. **D** The answer is lower of the sales price or appraised value. Basic concept review: LTV (loan-to-value) is always based on the lower of the sales price or appraised value.
10. **B** The answer is Closing Instructions. The Closing Instructions form has a specific agreement between the listing broker and the closing company to make it a scrivener of the broker.
11. **B** The answer is the seller must provide a copy to the buyer. The Off-Records Matter section requires the seller to provide documentation on title items “not shown by the public record.”
12. **C** The answer is 215–230. The agricultural right-to-cure period is 215 to 230 days.
13. **B** The answer is electrical fixtures. Basic concept review: Fixtures such as electrical wiring and plumbing automatically transfer with the deed. Trade fixtures, freestanding appliances, and emblements are considered personal property and will be listed on the bill of sale.
14. **D** The answer is the seller should cancel the counterproposal before accepting the new offer. The buyer has the right to withdraw an offer until communication that the offer has been accepted is received. The seller has the right to cancel the counterproposal until notice of acceptance has been received. The seller must cancel to accept another offer or chance having two executory contracts.
15. **C** The answer is deficiency judgment. Basic concept review: The lender has a deficiency created by the loss in the foreclosure, so the lender would file for a deficiency judgment, not a default judgment.
16. **D** The answer is as negotiated between the parties. The Evidence of Title and Closing Costs sections of the Contract to Buy and Sell Real Estate provide various options for payment of closing costs.



17. **C** The answer is be supervised by an active Colorado employing broker. Nonresident brokers have a Colorado real estate license and must meet all requirements to maintain an active license but do not require supervision by a Colorado employing broker.
18. **D** The answer is investigate and ask the broker for a response to the complaint. Upon receiving a complaint, the first step is for the Commission to investigate and ask the broker and any other parties to respond.
19. **C** The answer is 12 hours of ACU courses and 12 hours of electives. Brokers are required to complete 12 hours of ACU courses (one each year) and 12 hours of elective courses during each three-year license cycle.
20. **D** The answer is complete and present a CMA to a seller. Unlicensed assistants may not do anything that requires a real estate license, including offering opinions. The assistant may complete the CMA but should not present it to the seller because it could indicate the assistant's opinion on the value of the property.
21. **A** The answer is Notice to Terminate. The Notice to Terminate form is used any time the Contract to Buy and Sell Real Estate is being terminated.
22. **B** The answer is three years by December 31. Brokers' licenses expire and must be renewed every three years by December 31.
23. **D** The answer is finalize the agreement between the buyer and seller. The Inspection Resolution form is used to finalize any inspection issues between the buyer and the seller.
24. **C** The answer is by December 31 of each year. E&O coverage expires on December 31 of each year.
25. **D** The answer is a \$2,500 fine for damages and a revocation of license. The Commission may not fine for damages. They may censure, suspend, or revoke a license and may impose a fine up to \$2,500 per infraction.





## **Practical Applications**



# UNIT 1

## Practical Applications Lecture Outline

### LECTURE OUTLINE

#### I. COMPETENCY

##### A. Competency levels

1. Are you \_\_\_\_\_ to do what you've been asked to do?
  - a. List a house for a seller
  - b. Show a house to a potential buyer
  - c. Farm and ranch
  - d. Lease a property for a landlord
  - e. Commercial real estate
2. As a future broker-associate, you need to be aware that your \_\_\_\_\_ at this point is very low.
3. Specialties and competency requirements:
  - a. Commercial real estate is \_\_\_\_\_ specialized and requires \_\_\_\_\_.
  - b. Property management can involve \_\_\_\_\_.

- c. Property management frequently requires an employing broker's license.
  - d. Farm and ranch can involve \_\_\_\_\_ and/or mineral rights.
4. Because there are no standards for competency, it is the \_\_\_\_\_ to determine their areas of competence.
- a. Commission Position Statements in the CREM can be a guide.
5. To determine your competency level, ask yourself the following questions:
- a. Have I completed a similar transaction, such as
    - (1) single-family residence?
    - (2) commercial property?
    - (3) raw land, farm, or ranch?
    - (4) high-end property?
    - (5) property management?
  - b. Is there someone I can work with to get help?
  - c. Have I had \_\_\_\_\_ for this type of transaction?

## **B. How to gain competency**

- 1. Education and training
  - a. \_\_\_\_\_
  - b. \_\_\_\_\_
  - c. \_\_\_\_\_
- 2. Experience

## **II. PROPERTY MANAGEMENT**

### **A. Types of property management**

- 1. \_\_\_\_\_ property management
  - a. Single-family homes
  - b. Multifamily homes
  - c. Apartment complexes

2. \_\_\_\_\_ property management

- a. Office buildings and spaces
- b. Shopping centers
- c. Industrial developments

### **B. Leasing versus property management**

1. First, it is necessary to determine the difference between \_\_\_\_\_ and \_\_\_\_\_.
2. \_\_\_\_\_ is a onetime activity in which a licensee (broker-associate) works with a seller/owner to find a tenant for the property.
  - a. The licensee would check the appropriate box in the Exclusive Right-to-Sell Listing Contract or could use the Exclusive Right-to-Lease Listing Contract.
3. \_\_\_\_\_ is an ongoing relationship with a property owner to manage a property, including the \_\_\_\_\_ for leasing it.
  - a. This relationship would require a property management agreement signed by your \_\_\_\_\_.

### **C. Property management agreement**

1. The property management agreement is between the property owner and the \_\_\_\_\_ and includes the following:
  - a. Terms and payments
  - b. Duties of the firm and the property owner
    - (1) \_\_\_\_\_
    - (2) \_\_\_\_\_
    - (3) \_\_\_\_\_
    - (4) \_\_\_\_\_

### **D. Trust accounts**

1. Trust accounts are required for all money belonging to others that is accepted by a broker or brokerage firm.
  - a. Remember that \_\_\_\_\_ must have trust accounts and they must be in the name of the \_\_\_\_\_.

**E. Broker-Associates**

1. According to the Commission rules, “Before engaging in property management or leasing, the Broker should discuss with the Employing Broker whether the Broker is capable of and allowed to perform property management or leasing duties.... If the Employing Broker does not allow Brokers to perform leading and/or property management duties, the Broker needs to refrain from such duties or seek employment elsewhere.”
  - a. Refer to Commission Position Statements in the CREM
  - b. Broker-associates \_\_\_\_\_
    - (1) negotiate a lease without an agreement or
    - (2) help a friend out by offering to advertise, lease a property, or hold funds.

**III. ENTERING THE FIELD****A. Employment agreement**

1. You will most likely be working as an \_\_\_\_\_, not an employee.
2. Independent contractors \_\_\_\_\_ (ICA) when they are hired.
3. The ICA provides the details of your independent contractor status, including the following:
  - a. You will receive a \_\_\_\_\_ instead of a W-2 form.
  - b. You are responsible for paying your \_\_\_\_\_ and setting your own schedule.
4. Independent contractors receive training and are expected to implement the methods they were trained on as they see fit without the direct control of the brokerage.
5. Remember, you are starting \_\_\_\_\_ and with the aid of training will have the freedom to determine your \_\_\_\_\_ and work methods.

**B. Steps to get an interview**

1. Call the brokerage you are interested in working with.
2. Tell whoever answers that you are a new broker and are looking for a brokerage to work with.
3. Schedule an interview with whoever hires new brokers.
4. Remember that you are \_\_\_\_\_, not the other way around.
5. The brokerage you select will be key to getting your career off to a successful start.



**C. Questions to ask brokers**

1. Your book has a comprehensive list of questions to ask your brokers.
2. You will find it helpful to \_\_\_\_\_ and write down some of your own before interviewing employing brokers.
3. In this section, we will review a few of the questions we think are \_\_\_\_\_.
4. What \_\_\_\_\_ does the brokerage firm offer?
  - a. How long is it? How many days a week/hours per day?
  - b. Is there an extra fee for it?
  - c. Where will the in-person training be held?
  - d. Is there video or online training?
  - e. What happens after the initial training?
  - f. Is there continuing education?
  - g. Is there a new agent follow-up (accountability) program?
  - h. Do you have a mentor program?
  - i. Who will follow up with me to see how I am doing?
5. What does the firm \_\_\_\_\_ for brokers?
  - a. Business cards
  - b. Signs/sign riders
  - c. Copies
  - d. Lockbox
  - e. Free work space

(1) Remember, you may have a monthly bill that will include some of these costs; however, you are starting your own business and will incur most of the costs.
6. What \_\_\_\_\_ is available for brokers to use?
  - a. Websites
  - b. High-speed internet/Wi-Fi
  - c. Computer
  - d. Color printer
  - e. Copier/scanner

7. What are the \_\_\_\_\_ rates?
  - a. How are they paid (monthly or once per year)?
  - b. To whom are they paid (insurance provider or brokerage)?
  - c. Who is responsible for obtaining coverage?
8. Must I join a \_\_\_\_\_ of REALTORS®?
  - a. Do I need to be a REALTOR® to be a part of your office?
  - b. Must I join a specific local association?
  - c. What are the annual dues for that association?
9. \_\_\_\_\_ to get started that a broker-associate typically will pay for include the following\*:
  - a. Real estate license: \$200 (\$200 is for the first or partial year. At Year 2, you would renew your license for three years.)
  - b. E&O insurance: \$250/year
  - c. REALTOR® association dues: \$600/year (cost varies by local association)
  - d. MLS dues: \$49.50/month (cost varies by MLS)
10. What other \_\_\_\_\_ might I be asked to pay for?
  - a. Training fees
  - b. Start-up fee
  - c. Technology fee
11. You will be responsible for paying for the following:
  - a. Health insurance
  - b. Taxes: Social Security, self-employment, Medicare, and so on
  - c. Car insurance: some brokerages require additional insurance

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\* These are approximate costs, since the costs can change on an annual basis.

12. What are the \_\_\_\_\_ costs?
- a. Many brokerage firms have a monthly bill that may include the following:
    - (1) Advertising fee
    - (2) Technology fee
    - (3) Charges for copies, office supplies, and signs
    - (4) Charges for desk or office space
    - (5) E&O insurance
    - (6) Multiple listing service (MLS) charges are generally paid directly to the MLS by the broker-associate
13. What are the \_\_\_\_\_?
- a. You will most likely be splitting your commission with your brokerage firm.
  - b. For new brokers, commission splits vary from 50/50 to 70/30, the latter being most common.
  - c. Is there an annual cap for the amount paid to the brokerage?
  - d. Some brokerages determine your commission split based on your gross commission income (GCI). Your GCI is the amount that you receive before the commission is split. At some firms, as your GCI increases, you get to keep a larger portion of the commission.
14. Does the brokerage charge a franchise or royalty fee? (Most national firms generally have a 6% franchise fee.)
- a. What is the percentage?
  - b. Does this fee have a cap?

#### **D. Hiring paperwork**

1. When you sign up with a brokerage, you may need to complete the following:
- a. License application (completed online on the DORA website) (Before you can apply, your employing broker will give you information you'll need to complete your application.)
  - b. Proof of E&O insurance (Wait for your new broker to tell you how to do this, as it varies from brokerage to brokerage—some include it, some do not.)

**E. What is your job description?**

1. Find buyers and sellers to work with. This is called lead generation and is key to your success. There are two types of lead generation but many ways to perform them.
  - a. Prospecting: Actively finding someone who wants to buy or sell now or in the near future. Ask everyone you meet, “Are you or someone you know planning to buy/sell in the near future?”
  - b. Marketing: Passively communicating that you’re a real estate broker trying to attract clients to you via email, direct mail, advertising, social media, etc.
  - c. Many brokers use a mix of both methods. The most successful do more active prospecting and automate their email, direct mail, and social media. Many firms have back-end systems to help with this.
2. Know what to do when \_\_\_\_\_.
  - a. Be prepared to give a \_\_\_\_\_ to buyers and sellers so they want to work with you.
  - b. Study and practice your scripts and presentations so you know what to say.
  - c. Know who to go to when you \_\_\_\_\_.
  - d. Attend all the training focusing on lead generation and act. Starting small is better than not starting at all.

**F. Treat your new career like a job.**

1. Create an action-focused business plan and be consistent—hit or miss doesn’t work.

**Goals Worksheet**

1. During the next 12 months, I want to earn: \$\_\_\_\_\_
2. That works out to be monthly earnings of: \$\_\_\_\_\_
- (Line 1  $\div$  12)
3. Approximately 60% of my earnings should come from buyer sales \$\_\_\_\_\_
- (Line 2  $\times$  0.60)
4. Approximately 40% of my earnings should come from listings sold \$\_\_\_\_\_
- (Line 2  $\times$  0.40)

**Achieving my listing income:**

5. In my market area, the average listing commission amount is: \$\_\_\_\_\_
- (Get this amount from your MLS.)
6. I must have the following number of buyer sales: \$\_\_\_\_\_
- (Line 3  $\div$  Line 5)
7. If only 75% of my listings sell, I have to get this many listings: \$\_\_\_\_\_
- (Line 6  $\div$  0.75)
8. It may take this many listing appointments to get a listing: \$\_\_\_\_\_
- (Get this number from your broker.)
9. I need to go on this many listing appointments: \$\_\_\_\_\_
- (Line 7  $\times$  Line 8)
10. It may take this many calls to get an appointment: \$\_\_\_\_\_
- (Get this number from your broker.)
11. I have to make this many calls per month: \$\_\_\_\_\_
- (Line 9  $\times$  Line 10)
12. I have to make this many calls per week: \$\_\_\_\_\_
- (Line 11  $\div$  4.3 weeks per month)

**Achieving my sales income:**

13. In my market area, the average sales commission is: \$\_\_\_\_\_
- (Get this amount from your broker.)
14. I have to make this many sales per month: \$\_\_\_\_\_
- (Line 4  $\div$  Line 13)
15. It takes about this many showings to make a sale: \$\_\_\_\_\_
- (Get this number from your broker.)
16. I must show this many properties per month: \$\_\_\_\_\_
- (Line 14  $\times$  Line 15)

2. Think *systems*

- a. How much money \_\_\_\_\_?
- b. How many transactions will it take for you to reach that goal?
- c. How many contacts will you need to make per day, week, and month to achieve that goal? These are the daily tasks you control. It should be a part of your daily action plan.
  - (1) How will you make those contacts?
    - (a) In other words, what is your prospecting and marketing action plan/system?
      - i) Phone calls, door knocking, networking, emails, direct mail, etc.
      - ii) How many? How often?

## 3. What skills do you need to turn appointments into listings and buyers?

- a. Practice excellent presentation skills
- b. Knowledge of the market
- c. Use of scripts and dialogue

## 4. How will you track your leads?

- a. Follow-up is key. Follow up five times before you give up.
- b. What lead tracking system should you use (CRM)?
  - (1) The tracking system you use does not matter unless you use it and follow up with leads daily.

## 5. Prioritize your activities so lead generation gets done every day.

**G. Ideas for Prospecting and Marketing**

- 1. \_\_\_\_\_
  - a. Knock on doors in a neighborhood
  - b. Call \_\_\_\_\_ you know (sphere of influence) to ask if they or someone they know wants to buy or sell now or in the near future
  - c. Join a leads group
  - d. Call for sale by owners (FSBOs)
  - e. Contact expired listings
  - f. Hold open houses for \_\_\_\_\_

2. \_\_\_\_\_
  - a. Send direct mail to a geographic farm area
  - b. Email \_\_\_\_\_ you know about interesting real estate information or articles
  - c. Talk about real estate on Facebook, Twitter, and LinkedIn
  - d. Put your sphere on a monthly mailing list campaign (email, mail, pop-by with an inexpensive seasonal gift)
  - e. Advertise
    - (1) Community news letters
    - (2) School newspapers or folders
    - (3) Community events
    - (4) Social media ads
    - (5) Blog

#### **H. Prospecting and marketing ideas**

1. Farming (geographic or people)
2. Internet (email and social networks)
3. Sphere (referrals)
4. Buyer/investor seminars
5. Buyer/seller leads/websites
6. Develop a niche market
  - a. Seniors
  - b. Downsizers
  - c. Green buyers
  - d. Builders
  - e. Renters
  - f. First-time homebuyers
  - g. Divorcees

**I. Presenting your product—you!**

1. Most brokerage firms have prepared presentations \_\_\_\_\_ to tell buyers and sellers what you and your company can offer them.
2. Practice, practice, practice!
3. Handling objections: You will hear the same objections often, such as “We want to think about it.” Know how to respond to the most common objections and practice it (scripts and dialogue).

**J. Stay on the path to success**

1. Get out of \_\_\_\_\_.
  - a. In the beginning, you need to do both non-moneymaking activities (administrative) and moneymaking activities (client meetings).
  - b. Non-moneymaking activities are usually easier and more comfortable (i.e., posting on social media, writing emails, designing marketing pieces, and working on the computer).
    - (1) Ask yourself the following questions:
      - (a) Is this activity going to \_\_\_\_\_?
      - (b) How much busy work can I afford today?

**K. Typical workday**

1. Your goal: Ask as many people as you can if they want to buy/sell to achieve your financial goal of two closings per month.
2. Even coffee or lunch with a friend that is spent talking about real estate can produce business and referrals.
3. \_\_\_\_\_ and leads turn into appointments.
4. Practicing your presentation pays off with higher conversion rates from appointments to listings and buyer agency agreements.
5. Get to know your area market: preview new properties that come on the market, go look at new homebuilders, new custom construction, etc.
6. Start to build your resource third-party provider team.
  - a. Mortgage companies
    - (1) A couple of good lenders are a part of all great real estate teams.
  - b. Home inspection companies
  - c. Title companies
  - d. Specialty vendors (structural engineers, electricians, plumbers, etc.)



#### IV. PROFESSIONAL EDUCATION

##### A. Technical knowledge

1. Using the \_\_\_\_\_
  - The MLS will require you to take a class when you join.
2. Preparing CMAs
3. Preparing \_\_\_\_\_
  - Using CTM software
4. Preparing required documents
5. Reviewing settlement statements
  - Many title companies offer these types of classes.

##### B. Product knowledge

1. Take \_\_\_\_\_
  - a. Lead generation
  - b. Scripts and dialogue
  - c. Presentations
  - d. Homebuilding
  - e. Software classes (MLS, CRM system, etc.)
2. Know title, inspections, appraisals, and financing options
3. View \_\_\_\_\_ (schedule a preview rather than a showing)
4. Become familiar with the marketplace and neighborhoods

##### C. Professional designations

1. There are \_\_\_\_\_, such as the following:
  - ABR®: Accredited Buyer's Representative
  - CCIM: Certified Commercial Investment Member
  - CPM®: Certified Property Manager®
  - CRS: Certified Residential Specialist
  - GREEN: NAR's Green Designation

- GRI: Graduate, REALTOR® Institute
- RENE: Real Estate Negotiation Expert
- SRES®: Seniors Real Estate Specialist®

See the full list of designations here: [www.nar.realtor/education/designations-and-certifications](http://www.nar.realtor/education/designations-and-certifications)

## **V. CURRENT TRENDS**

### **A. Social media**

1. Some examples:
  - a. Facebook
  - b. Twitter
  - c. LinkedIn
  - d. Instagram
2. Can be great tools if \_\_\_\_\_
3. Need to know site guidelines and your client's wishes
4. License law regarding advertising still applies when using social media
  - a. How can real estate teams advertise?
5. Don't give the \_\_\_\_\_ on social media sites when you are trying to gain a business advantage or information. Create a business profile instead.
  - a. Before posting ad copy and photos, have your employing broker review them. Do not use photos, plans, or videos created by others without written permission from the creator.
6. Receive \_\_\_\_\_ before posting the following:
  - a. Photos
  - b. Virtual tour
  - c. Open house locations

### **B. Marketing**

1. Real estate continues to become \_\_\_\_\_, but don't forget "high touch."
2. Real estate is still a people business.
3. People like to do business with brokers \_\_\_\_\_.

4. Use technology with a personal touch.
5. Often a \_\_\_\_\_ can move a client forward.
6. Make sure you are easy to find in internet searches.

## PART 2

### I. BROKER SAFETY

#### A. Safety tips

1. Hold the first meeting with new clients at your office or a public place.
2. When working with someone you don't know, don't go alone. Take someone with you: a coworker, partner, friend, child, lender or title rep, etc. There is safety in numbers.
3. When hosting an open house, invite someone along. Never do it alone.
4. Be assertive and confident. When you feel uncomfortable or sense any threat, excuse yourself for a call or to retrieve something from your car.
5. In every situation, trust your instincts. It's better to be too cautious than not at all.

### II. OFFER TO CLOSING

#### A. Working with buyers and sellers

1. The next section will give you a broad overview of the process of working with buyers and sellers. At the end of the section we will work on a case study.
2. This is where your company training will pay off (i.e., practicing presentation skills, completing a CMA, writing a contract, setting showings).
3. Be sure to get help from your \_\_\_\_\_.
4. Education: Use your buyer/listing presentation \_\_\_\_\_ buyers and sellers and keep yourself on track.
5. Customer service: what will you do to provide top-quality service?
  - a. Think of things that will help you stand out with buyers and sellers. Write your ideas here:

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6. Helping buyers and sellers to \_\_\_\_\_

- a. Prequalify buyers
- b. Give sellers an accurate \_\_\_\_\_

### **B. Working with buyers**

1. Meet with buyers \_\_\_\_\_ how you work and the process of buying a property (use your buyer presentation).
2. Determine your \_\_\_\_\_ with them (part of your buyer presentation).
3. Determine what and where they want to buy.
4. Prequalify buyers to determine what they can afford.
  - a. You can request that this \_\_\_\_\_ your meeting.
    - (1) “Before we meet, would it be OK if I have a lender call you so that we can determine what price point you are most comfortable with?”
5. Call and schedule showings (some can be done online now).
6. Show them properties.
7. Call the listing broker and lender.
8. Write the offer (with the help of your mentor).

### **C. Working with sellers**

1. Do your homework (i.e., CMA, seller’s net sheet) in advance so you are ready to make a \_\_\_\_\_ and take the listing.
2. Pre-qualify the seller.
  - a. Where are you moving?
  - b. When do you need to move?
  - c. For what price do you think your home will sell?
  - d. How much do you currently owe on your home?

3. Arrive at the appointment \_\_\_\_\_ and ready to show the sellers why they should list with you.
  - a. Use your customized listing presentation, including information about you and your company. It should also include the following:
    - (1) Your CMA
    - (2) Seller's estimated net proceeds
    - (3) A plan for how you will market the property

### III. CASE STUDY

You will need your supplement books for this case study. Turn to the Residential Contract to Buy and Sell.

In the following case study, you will complete the Contract to Buy and Sell. You are a broker-associate for Sunny Hills Realty, Inc. In March of this year, a past customer referred Bob and Sandy Smith to you. At your request, they visited Security Atlantic Mortgage Company, which preapproved them for a mortgage loan of up to \$200,000.

You learn that they want a three- or four-bedroom home with two baths and a two-car garage. They want a home in the northeast, less than five miles from the regional hospital where Bob is a pharmacist.

You describe the entire process of buying a home, from showing homes through moving into their new home. You tell them it is a sellers' market, and that listings sell almost as soon as they go on the market.

You explain the lender's loan application disclosure with them and discuss the important clauses in the purchase agreement. You give them copies of the paperwork along with a Brokerage Disclosure to Buyer. Because they have enough cash for a 20% down payment (80% loan), you can show homes in the \$250,000 range ( $\$200,000 \div 0.80$ ).

#### Finding the Right Home

You set a showing appointment for Saturday and begin previewing homes that might satisfy their requirements. You find five houses that seem like real possibilities; one of them is just about perfect. It is located at 816 Harrison Court, a quiet street in a well-kept neighborhood, just two miles from the hospital. The owners have kept the home in wonderful condition. And it has great curb appeal. The home is listed by Blue Sky Realty, Inc., and is priced at \$255,000. Perfect! You make appointments to show the homes.

On Saturday morning you show your favorite home first. Bob and Sandy love everything about it. The home has no apparent problems. It doesn't take long to walk through the remaining houses because they are more interested in the first home. You suggest a return visit and clear it with the listing company, who calls the sellers and then tells you the sellers are going out for several hours and the house will be available most of the day. After returning to the home, you stay unobtrusive and let the Smiths discover more features of the home. They want to think it over. You cover the market conditions with them again and explain that if they love it, it is likely that other buyers will, too.

## Writing the Offer

You suggest that, even if they end up “sleeping” on the decision, it might be helpful if they had the offer filled out. Bob says to make the paperwork out as if they were paying \$245,000. Bob wants to see the backyard again, so you suggest they look around some more while you complete the paperwork.

The sellers have requested an earnest money deposit of \$5,000. Based on previous conversations, the Smiths will want to be in the home in 30 days. Because the sellers are in town, and because the market is so active, you will give them until 10:00 pm tonight to accept or reject the offer.

You call the listing broker to confirm that the time for acceptance and closing will work. The listing broker states that the time frame is fine if you get the offer by 1:00 pm today, but that seller will need 45 days to close. The two of you verify that all the other information you need is in the Contract Writing package that you picked up on the property.

The package shows the following information:

Sellers' names: Larry and Wilma Palmer

Street address: 816 Harrison Court, Sunny Hills, CO

Legal description: Lot 18, Block C, Old Hills as recorded in book 126, page 368, Lake County

Title company: J.P. Title Company, Inc.

Earnest money: \$5,000 made payable to the title company

Personal property included: range, draperies, rods, and window treatments

The buyers also want to include the refrigerator, the washer and dryer, and the riding lawn mower. You explain that these items are not included in the sale, but they want to try for them anyway.

## Preparing the Contract to Buy and Sell (CBS)

You will need to have a copy of the current Contract to Buy and Sell for this exercise. This can be found on the Real Estate Commission website.

Just as you are finishing the contract, Sandy and Bob return to the kitchen. You tell them it's a great home, and well-priced at \$255,000. You ask if there is anything they want to do to the home after they buy it and Bob says he wants to pour a concrete patio.

You go over the contract form carefully. Sandy says it all looks good. You say “You could go home and worry about this tonight or I could take this to the seller and you might have great news to celebrate tonight. Wouldn't it be better if we went ahead?” Wait for the answer—in many cases, the buyer will agree.

If the Smiths agree, ask them to approve the agreement with their electronic signatures.

Remind them about the earnest money deposit and ask them for a copy of the lender letter stating that they can qualify for the home. To prepare them for a counteroffer, ask that they not be too disappointed if the seller does not accept the offer at \$245,000. After emailing the offer and lender letter to the listing broker, you should immediately contact the listing broker, Hillary Jenkins, to let her know you have emailed her an offer.

## Sellers' Responses to an Offer

Sellers who receive an offer on their home have several possible responses:

- Acceptance
- Rejection
- Counteroffer

### Acceptance

Obviously, the buyer's broker-associate hopes the response will be an acceptance. In this case the offer is signed and becomes a contract between the buyer and the seller.

### Rejection

If the price offered is very low and is obviously a "fishing expedition," the seller may be advised to reject the offer outright. A better approach might be to reject the offer with an invitation to come back with a more serious offer. In a strong sellers' market with many buyers bidding for the same properties, brokers report that sellers often reject offers unless they are very close to the asking price.

### Counteroffer

If the offer is not acceptable but is close enough to be considered serious, a counteroffer should be used. A counteroffer keeps the parties "at the table," making continued negotiations easier.

The approved Colorado Counterproposal form must be used when countering an offer. The form is used only to note the changes to the original offer and must be attached to the offer to be valid. The earnest money is also still attached to these documents. Earnest money is not deposited until the offer is accepted.

**Remember:** The seller will *not* sign the offer but will sign the Counterproposal.







# Trust Accounts and Recordkeeping

**Unit 1:** Trust Accounts and Recordkeeping



# UNIT 1

## Trust Accounts and Recordkeeping

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Define the term *trust account*.
- › Summarize the requirements for trust accounts.
- › List the types of trust accounts.
- › Describe the requirements for earnest money deposits and earnest money promissory notes.
- › Explain recordkeeping rules and safeguards.
- › Discuss property management trust accounts.

### KEY TERMS

account journal

audit

beneficiary ledger card

good funds

operation account

reconcile

transaction files

trust account

### OVERVIEW

A **trust account** is a separate bank account established to hold money for the benefit of others. The money in the trust account belongs to other people—called beneficiaries—and it is only in the temporary custody of the trustee or fiduciary. Because the money belongs to others, it is subject to very specific controls and requires a high level of accuracy and care. Trust accounts have strict accounting requirements, in addition to the requirements on how the account can be established at a bank. Colorado real estate trust accounts must follow specific statutes and Commission rules.

Real estate brokerage firms frequently maintain one or more trust accounts to hold money they receive as part of real estate transactions or the management of properties. As part of protecting the public, the Colorado Real Estate Commission takes very seriously the accounting of monies collected by principal brokers, collected by broker-associates, and held by brokerage firms or title companies as part of real estate transactions. In Colorado, only principal brokers who are either an employing or independent broker may have trust accounts. Broker-associates, at any license level, are not allowed to keep trust accounts. This means for new broker-associates, there is no worrying about setting up trust accounts. However, all licensed brokers are responsible for collecting earnest money and other funds and seeing that the funds are delivered or deposited correctly. Additionally, property managers are responsible for making sure all security deposits, rents, and funds used for property maintenance are properly accounted for in the brokerage firm's property management trust account.

Typically, each brokerage firm will also have a company operating account, which is not a trust account. The funds in the operating account will be the property of the principal broker or brokerage firm and used for operating expenses. When the firm earns a commission and splits it with a broker-associate, the employing broker deposits the commission check into the operating account and then writes an operating account check for the commission split to the broker-associate. Brokerage firm operating expenses cannot be paid directly into or out of the trust account. These funds must be separate from the funds held in trust. Combining operating and trust funds is called *commingling* and is illegal.

After two years, a broker-associate can choose to become an independent broker and at that time become responsible for maintaining proper trust accounts.

## Establishing Trust Accounts

If the principal broker is going to hold trust funds in a brokerage firm account, he must establish a trust account at least by the time money belonging to others is first received. Good business practice would dictate that principal brokers establish trust accounts as part of first establishing their brokerage firm so such accounts will be already available when the need arises.

If a principal broker holds no money belonging to others, no separate trust account is required. The brokerage firm and principal broker may choose to allow a title company to hold the trust funds; however, the brokerage firm and principal broker remain responsible for the funds and what happens to them. This means if the title company closes, loses the funds, or improperly handles the money, the principal broker is also considered a responsible party.

The principal broker has a great deal of personal responsibility for the trust accounts that bear the brokerage's and principal broker's names. The principal broker must actively supervise the accounting procedures used to keep track of the accounts and to maintain adequate security over the money in the accounts. The principal broker is also charged with the supervision of all employed broker-associates and making sure that she properly handles all money received (C.R.S. 12-61-103(8) and 12-61-113(1)(g)(n) and (o)). The principal broker may delegate, in writing, the accounting for trust accounts to another responsible party in the company. The principal broker is of course still responsible and must maintain control over all the accounts and accounting.

An additional requirement is that the principal broker must be able to withdraw funds from the trust account without a cosigner. The principal broker may authorize other signers on the account, who may be licensed or unlicensed. An unlicensed assistant or office manager may sign checks if authorized by the principal broker.

The principal broker's (or firm's) funds must not be commingled with funds belonging to beneficiaries of the trust account. For example, the brokerage firm may not keep trust funds and operation funds in the same account. However, brokerage firm funds sufficient to open and operate the account may be kept in a trust account. While the amount of brokerage funds permitted in the trust account is not specified by the Commission, it should not be in excess of what might be considered a reasonable amount. A broker's or brokerage ledger card will keep track of how much of the brokerage funds are being used in the firm's trust accounts.

## Types of Trust Accounts Used

Trust accounts contain earnest money, rents, and security deposits, among other funds. Depending upon the needs of the brokerage firm, the number and types of accounts needed will vary. A large company or one performing many types of real estate brokerage services may need a number of trust accounts to ensure that funds for various purposes and beneficiaries are not improperly mixed. A small brokerage specializing in residential sales may require only one account or none at all. The number is determined by the requirement to ensure the funds are properly accounted for, not by the amount of money in the trust account.

The type of funds to be held is the deciding factor, and the number of accounts can range from none to unlimited. The following are the most common trust accounts:

- Sales trust account—for money held in connection with sales transactions pending closing (earnest money)
- Management trust account—for money held in connection with property management services (rents and other income belonging to the property owner)
- Security deposit trust account—for refundable security deposits collected from tenants or short-term occupants for lease and rental units under management by the principal broker (tenant's money, which is fully accountable to the tenant)
- Advance rental—for rental money collected in advance, especially for short-term rentals as experienced in resort and vacation rentals (this is not security deposit money)
- Homeowners association trust account—for funds held on behalf of condominium or planned community associations (use a separate account for each association and identify the account with the tax identification number of each association—this money belongs to all the owners as a group and is differentiated from an individual property owner)

Most sales firms will have a sales trust account for earnest money, or they will not have any trust accounts and simply use the title company to hold these funds. A property management company will typically have a management account and a security deposit account. If the company also does sales, the principal broker may decide to establish a sales trust account for earnest money.

The operations account is used by the brokerage firm to take care of day-to-day expenses to run the office. Once a commission is earned, the funds are deposited into the firm's **operation account**, and a check to the broker-associate is then written for the broker-associate's share of the commission.

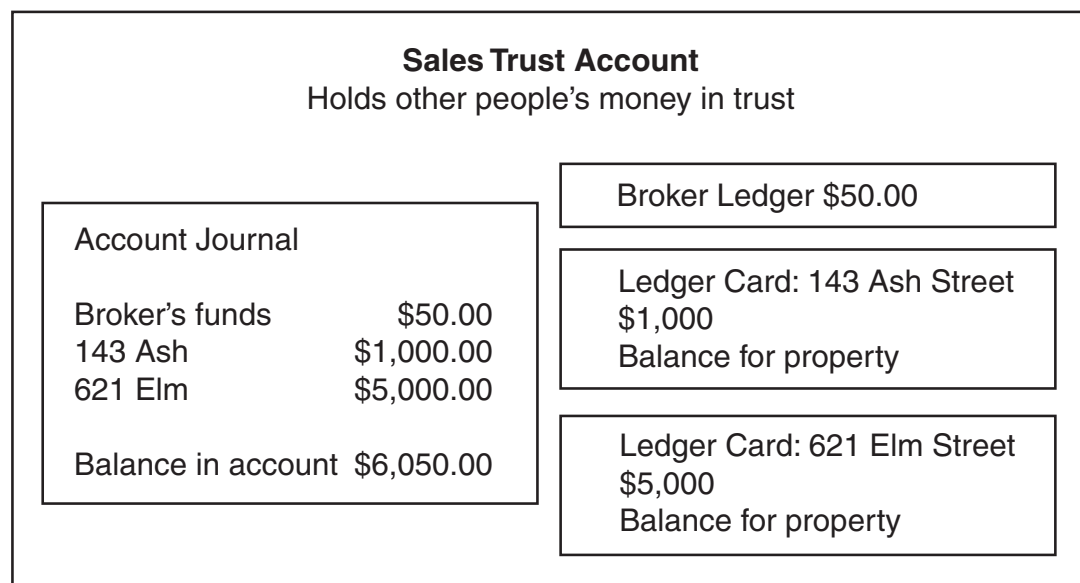
The funds going into a trust account come from a written document, and the accounting system used to maintain and **reconcile** the trust account must make note of which document or documents the funds came from. This documentation is kept in a transaction file. For example, the Contract to Buy and Sell states that the listing brokerage firm will hold the earnest money until termination, closing, or default. The amount and form of the earnest money are also listed. The Contract to Buy and Sell is kept in the transaction file, and the principal broker would create a new **beneficiary ledger card** that details where the funds are from, what document gave the brokerage permission to hold the earnest money, the property information, and so forth. All trust funds must be traceable back to the written agreement, bill, or invoice.

The beneficiary ledger is used to keep track of the money for a property. The amount and address are also entered into the **account journal**, which is used to keep track of all the funds within a trust account. A typical firm might be holding money from 20 or more different properties. The ledger card tells the principal broker the details of the property and funds, while the account journal keeps track of all the funds within the trust account.

The trust account should not be used to hold funds belonging to broker-associates except as part of an executory sales contract to which the broker-associate is a party. Employee benefit funds and tax withholding funds may not be deposited in these types of trust accounts.

If a principal broker advances funds for the benefit of a client, the funds may be placed in the trust account and identified as an advance. The funds may not be withdrawn except on behalf of the client. The funds may be repaid to the principal broker or withdrawn for the principal broker's use only with the consent of the client.

### Figure 1.1: Sales Trust Account



## Requirements of Trust Accounts

Trust accounts must be in a bank or recognized depository in Colorado that is insured by an agency of the U.S. government. The agency that is most often involved is the Federal Deposit Insurance Corporation (FDIC), which insures deposits in both commercial banks and savings and loans.

The Colorado Real Estate Commission requires separate trust accounts for each type of activity when a brokerage firm is holding money belonging to others. In addition, each account must have the type of account clearly labeled in the documents used to establish the account to reflect the fiduciary nature of the account.

All trust accounts must be identified in the bank records and on bank statements with the following specific information:

1. The company name as registered with the Commission
2. The personal name and capacity of the principal broker responsible for the account
3. The type of trust account, such as sales or property management
4. The account records, checks, and deposit slips stating that it is a trust or trustee account

A company trust account might be identified as follows:

- For a sole proprietor brokerage (licensed under a trade name) sales trust account:
  - Integrity Realty Company  
Susan R. Smith, Broker,  
Sales Escrow Account  
1423 Main Street  
Homestead, Colorado 80999
- For a corporate property management firm's management and security deposit accounts:
  - Exceptional Management, Inc.  
William A. Johnson, Broker  
Property Management Trust Account  
1 Priority Blvd., Ste. 222  
Uptown, Colorado 81111
  - Exceptional Management, Inc.  
William A. Johnson, Broker  
Security Deposits Trustee Account  
1 Priority Blvd., Ste. 222  
Uptown, Colorado 80111

The principal broker setting up the trust account must ensure that the name of the account is specific enough that the bank recognizes it as a trust account. This type of account is protected from actions against the principal broker because the money belongs to beneficiaries, not the principal broker. A Notice of Escrow or Trust Account form is executed between the principal broker and the banking institution to document this protection. This notice can be created using the principal broker's letterhead and must be maintained in the principal broker's files. Additionally, funds must be available for immediate withdrawal without penalty from these accounts.

A real estate firm may have other operating accounts in the name of the firm or the principal broker of record, but the Real Estate Commission is primarily concerned with the safety of money belonging to others. The Commission auditing staff will not ordinarily scrutinize operating accounts.

Other locations or branch offices of a brokerage firm may use the trust account(s) of the primary office. If a branch office maintains separate trust accounts, a separate recordkeeping system must be maintained in each branch office.

## Interest-Bearing Trust Accounts

A principal broker may not use trust account funds to earn undisclosed profits. The statute and the Commission rules permit the funds to be held in interest-bearing accounts under the following conditions:

- If the principal broker or one party to the transaction is to benefit from the interest income, all parties with an interest in the funds must provide their informed consent. They must agree to any risks or penalties for early withdrawal. They must also agree to whom the interest will go to in the event the transaction is either consummated or defeated.
- If an affordable housing program benefiting Colorado residents will receive the interest, the principal broker must post a notice in the office indicating that the company participates in such a program. The most used program is operated through the Colorado Association of REALTORS® and is called Colorado Association of REALTORS® Housing Opportunity Foundation (CARHOF). The seller and buyer give permission for the transfer in the Contract to Buy and Sell.

## EARNEST MONEY

### Earnest Money Deposits

Earnest money can be anything the seller will accept: cash, personal check, or property. The most typical form of earnest money is a personal check from the buyer to be held by the listing brokerage for the seller. Earnest money received must be deposited in the trust account not later than the third business day following notice of acceptance of the offer. The offer must clearly define who will hold the funds, the type of funds used, and where the funds are being held. If a check is to be withheld from deposit for any reason, the reason for holding the deposit must be disclosed in the contract, or the seller should provide written instructions to withhold deposit of the check.

If the offer was sent electronically and the buyer's broker is holding the earnest money instead of delivering it to the listing broker, the buyer's broker is obligated to deliver the money to the listing broker immediately upon acceptance of the offer. The buyer's broker should have sent a copy of the buyer's check (or other verification that the buyer's broker has the funds) along with the offer. It is important that the buyer's broker actually collects the funds per the terms of the contract before the offer is made; this allows the buyer's broker to easily deliver the



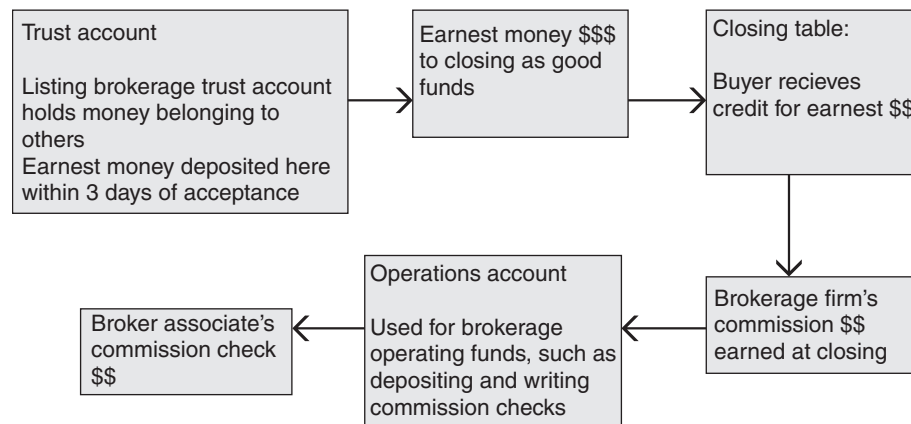
funds upon acceptance. It would be inappropriate to collect the earnest money funds after the offer was accepted, unless it was clearly stated in the contract that the earnest money was to be delivered by the buyer after acceptance.

If the purchase does not close and there is no dispute regarding the earnest money, it is to be returned to the appropriate party. The principal broker may *not* require the parties to sign a release in order to disburse the money if there is no dispute as to who is to receive the money. Of particular concern to the Commission is a broker requiring all parties to sign a release that holds the broker harmless and uses exculpatory provisions to limit the broker's liability. There is an approved Earnest Money Release form that may be used to show all parties are in agreement with the return of earnest money. If an Earnest Money Release is used, the seller will have three days to sign and return the release to the brokerage firm or buyer. Per the closing instructions, the holder of the earnest money will then have five days to return the money to the buyer. The Commission is concerned with ensuring that brokerage firms do not unduly hold funds for more time than necessary to obtain release signatures.

If there is a dispute regarding the earnest money, the broker may hold the money in the trust account until the parties provide mutual written instructions. The broker may also choose to interplead the money (surrendering it to the court if a lawsuit is pending or has commenced). This action can result in the broker forfeiting any claim to the money and also being removed as a defendant in the litigation. In the case of this court action, the broker may recover associated court costs and attorney's fees.

In the event the parties do not reach an agreement and no lawsuit is initiated, the broker holding the earnest money could be required to hold the earnest money indefinitely. To address this potential problem, the Real Estate Commission has inserted language in the Contract to Buy and Sell to assist the holder of the earnest money should this situation arise. This wording provides for the broker to notify the parties that, unless an agreement is reached or a lawsuit is initiated within 120 calendar days of the notice, the broker is authorized to disburse the earnest money to the buyer.

**Figure 1.2: The Trail of Earnest Money to Commission Check**



**Figure 1.3: Earnest Money Release**

The printed portions of this form, except differentiated additions, have been approved by the Colorado Real Estate Commission (EMR 83-6-21) (Mandatory 1-22)

**THIS FORM HAS IMPORTANT LEGAL CONSEQUENCES AND THE PARTIES SHOULD CONSULT LEGAL AND TAX OR OTHER COUNSEL BEFORE SIGNING.**

### EARNEST MONEY RELEASE (With Mutual Release)

Date: \_\_\_\_\_

**1. Parties, Property, Contract, Earnest Money Deposit:**

- a. Seller \_\_\_\_\_
- b. Buyer \_\_\_\_\_
- c. Property \_\_\_\_\_
- d. Date of Contract \_\_\_\_\_
- e. Earnest Money \$ \_\_\_\_\_

**2. Earnest Money Distribution.** Buyer and Seller agree that the Earnest Money will be distributed as follows:

- a. \$ \_\_\_\_\_ payable to: \_\_\_\_\_
- b. \$ \_\_\_\_\_ payable to: \_\_\_\_\_
- c. Other: \_\_\_\_\_

If the Contract required the Earnest Money to be placed in an interest-bearing account, the interest shall be disbursed as follows:

**3. Mutual Release.** The parties mutually release each other from any and all claims, demands, obligations, damages and causes of action pertaining to the Contract or the Property except the parties do not release each other from any claims arising under the Section titled “**Damage, Liens and Indemnity**” of the Contract, which specifically survive this Earnest Money Release.

☐ If this box is checked, the parties do **NOT** release each other of liability from the Contract.

This Earnest Money Release may affect legal rights or claims of the parties. Buyer and Seller are advised of their right to obtain legal counsel.

Date: \_\_\_\_\_

Date: \_\_\_\_\_

\_\_\_\_\_  
Buyer

\_\_\_\_\_  
Buyer

Date: \_\_\_\_\_

Date: \_\_\_\_\_

\_\_\_\_\_  
Seller

\_\_\_\_\_  
Seller

## Earnest Money Promissory Note

The earnest money promissory note is used when the prospective purchaser is not providing earnest money in cash, check, or property. There are many reasons the purchaser may not wish to or may not be able to provide liquid earnest money at the time the offer is made. For example, the purchaser may have funds tied up in a certificate of deposit with an early withdrawal penalty and may not wish to liquidate the funds until the offer is accepted. In discussion prior to the offer being made, the listing broker should help the seller evaluate the reasons and the amount of security provided by a note, and then the seller should decide whether the promissory note is acceptable. If the seller will accept the note, the listing broker will inform the buyer's broker, who will write the offer and clearly identify that an earnest money promissory note is being used, including the due date and the signed note attached to the offer.

The listing broker is responsible for presenting the note for payment in a timely manner for redemption and informing the seller if it is not paid. Notes or checks for earnest money are to be made payable to the listing brokerage firm, which is responsible for timely collection of the note. Any costs associated with collecting the note are the responsibility of the buyer, without limitation.

A signed promissory note must be due before closing so the funds will be available in the broker's trust account as good funds to be disbursed at closing. Once the note is paid, the money is then deposited into the broker's trust account or otherwise disbursed as agreed by the parties.

**Figure 1.4: Earnest Money Promissory Note—Sample Only**

The printed portions of this form, except differentiated additions, have been approved by the Colorado Real Estate Commission (EMP 80-5-04)

## EARNEST MONEY Promissory Note

U.S. \$ \_\_\_\_\_

\_\_\_\_\_, \_\_\_\_\_ Date: \_\_\_\_\_  
City State

FOR VALUE RECEIVED,

\_\_\_\_\_  
Name(s) of Maker(s)

\_\_\_\_\_  
Address

jointly and severally, promise to pay to the order of

\_\_\_\_\_

the sum of

\_\_\_\_\_ Dollars,

with interest at \_\_\_\_\_ per cent per annum from \_\_\_\_\_ until paid.

Both principal and interest are payable in U.S. dollars on or before \_\_\_\_\_, payable at

or at such other address as note holder may designate. Presentment, notice of dishonor, and protest are hereby waived. If this note is not paid when due, I/we agree to pay all reasonable costs of collection, including attorney's fees.

\_\_\_\_\_  
Maker's signature

\_\_\_\_\_  
Maker's signature

This note is given as earnest money for the contract on the following property:

## RECORDKEEPING

### Trust Account Records and Recordkeeping Systems

Every real estate brokerage firm or independent broker must keep **transaction files** with copies of various documents and supporting information. Commission rules describe the contents of the required closing files for listing and buyer's brokers, whether the broker is acting as an agent, the broker is acting as a transaction broker, or the seller or buyer is a customer. All files and records must be retained for four years by the brokerage firm.

Every brokerage firm that maintains a trust account must maintain a recordkeeping system for each trust account. The accounting system may be manual or computerized, but it must contain all of the following types of records and historical reports.

#### **Account Records**

In addition to the bank account agreement and Notice of Maintaining a Trust Account form for each trust account, the broker must maintain the following records:

1. Account journal of all cash receipts/disbursements—a chronological record of all money going into and out of the account plus a running balance of the account at any one time. All entries come from matching ledger cards. The journal is used to account for all the ledger cards and the balance of all money in the trust account. It does not contain transaction-specific information such as Social Security or tax identification numbers.
2. Beneficiary ledger card system—a series of individual records segregating receipts and disbursements as they affect individual beneficiaries or transactions. The ledger contains transaction-specific information such as Social Security and tax identification numbers.
3. Broker ledger card—a record of brokerage funds used to open and maintain the account and cover related service charges as they are incurred.
4. Bank reconciliation records—the trust account must be reconciled to the bank statement at least once a month in any month where there is account activity. The reconciliation records must be retained with the account records.

#### **Transaction Files**

No funds may go into or out of a trust account without proper documentation. Individual transaction files are where the required documentation is kept and used to support the financial activity in the account, including invoices or other documents to support disbursements. These would include the Contract to Buy and Sell, management agreements, bills, and so forth—any financial paperwork for the property. This file's monetary documentation should match what is noted on the beneficiary ledger card.

Samples of these records for a manual accounting system can be found in the Colorado Real Estate Manual. If a principal broker uses a computerized accounting system, the broker must ensure that the various reports and other records required by the Commission can be generated by the system.

Account journal entries must sufficiently identify the funds and include the date, name of the party giving the money, name of the beneficiary (seller, tenant, owner, and so forth), property identification, document reference, and amount. Disbursements must also include the check number. The ledger entries also include the specific details for the property and the parties, such as Social Security numbers and contact information.

Transaction files should include bids, invoices, contracts, or other written documents that must support disbursement of funds from a trust account. Deposit slips should be accompanied with details about the type of funds tendered (such as earnest money), who tendered the funds, and the transaction or property. Disbursements should be accompanied by receipts or invoices identifying the purpose of the payment, the property address, and the account or principal involved. All documents pertinent to the sale, management agreements, and so forth are to be maintained in the transaction file.

## Safeguards

Even in a corporate brokerage firm, the principal broker has personal responsibility for the proper maintenance and security of the trust accounts. Several specific practices can help reduce the risk of loss through accidental clerical errors, improper practices, and employee dishonesty. Too often a principal broker with a trust account shortage did not know it was short and does not know where the money went. Often it stems from poor recordkeeping or improper accounting. Safeguards include the following:

1. **Frequent reconciliation to the bank.** Because the bank statement reflects the funds actually present in the account, frequent reconciliation will point out any inconsistencies soon after they happen. A proper reconciliation balances all of the ledger cards with the journal balance and with the actual cash balance in the bank. If the account does not balance, the principal broker must quickly determine what the issue is and rectify the problem.
2. **Separation of duties.** The person who is in charge of the everyday bookkeeping should not normally do the bank reconciliation. As an alternative, the bank reconciliation may be reviewed in detail by the principal broker. If the principal broker does all the bookkeeping, a review by an accountant could spot problems the broker does not notice.
3. **An outside audit.** A broker with a large or very active trust account may wish to have a company auditor or CPA review the account status on an annual basis to catch problems before they become serious. Homeowners associations must have such an **audit** on their accounts.

## Commingling and Conversion of Trust Funds

*Commingling* of funds is simply defined as the **improper mixing** of funds within an account. In a sales trust account, the most common type of commingling (mixing) of funds is between broker funds and trust funds. For example, once a commission or fee is paid from trust account funds, it is earned and becomes the broker's money. It must then be withdrawn from the trust account promptly and transferred to the broker's operating account. Failure to do so results in funds that now belong to the broker commingling with trust funds.

*Conversion* is defined as the illegal use of one party's funds to the benefit of another party. In property management accounts, conversion can occur in several ways. In an account where funds are held for several beneficiaries, using funds belonging to one beneficiary for the benefit of another is conversion.

**FOR EXAMPLE**

If a broker managing two properties pays a bill for owner Ann at a time when there is sufficient money in the trust account to cover the check, but not enough on Ann's ledger card to pay the bill, this results in a negative balance in Ann's ledger. The shortage must come from the other owners' funds. Now, the second owner's funds have been converted to benefit Ann. The broker should have requested that Ann send money to cover the bill so funds would not have been converted.

To avoid this kind of illegal act, each owner's ledger card must be reconciled before funds are either disbursed for the benefit of an owner or paid directly to an owner.

A single bank account may be used for a number of managed properties, but the ledger accounting must be accurate for each of the different properties and must avoid a negative balance for any property or owner as described earlier. Various arrangements could be used in the event an owner's obligation needs to be paid when insufficient funds are available. The bill could be sent to the owner for payment by the owner, the owner could be notified to remit additional funds into the trust in order for the broker to pay the bill, or the broker could advance funds by making a deposit into the trust for the benefit of the property owner. Any of these procedures would avoid a negative balance in the owner's ledger, which would automatically result in the illegal conversion of funds. A ledger card may often have a zero balance but should never have a negative balance.

The principal broker must furnish accurate accounting reports to the owner within 30 days after the end of the month in which funds were received or disbursed. The management agreement may provide for a specific accounting schedule, which may be more or less frequent than this.

## PROPERTY MANAGEMENT

Principal brokers engaged in property management have additional rules they must comply with because of the more complex financial arrangements common in property management agreements. The concerns of the Commission are the same: the protection of other people's money and the accurate accounting for funds held in trust. Funds received in connection with property management activities must be deposited within five business days of receipt.

### Property Management Transaction Files

The following files are used in property management:

- Current/past management or short-term reservation agreements
- Current/past lease or rental occupancy agreement
- Lead-Based Paint Disclosure for residential property built before 1978
- Disclosure of brokerage relationships and listing contracts to lease
- Disclosure of compensation/service income from affiliated entities
- Accounting/tax reports/records required by Commission regulations or other laws
- Ongoing contracts, bids, or invoices from vendors, service providers, travel agents, or marketing organizations
- Legal notices, actions, or accounting reports affecting owner/occupant/tenant funds

- Documentation for commissions/fees earned versus those taken/charged to others
- Evidence of prompt assessment and timely (within 45–90 days) collection and restitution of all money due to the broker's trust account from any source
- Documentation verifying reported receipts, income, and all expenses paid for another

## Accounts

In addition to the sales trust account, a property management broker will usually require a management trust account and a security deposits trust account, which were described earlier. In certain circumstances, an advance rental account or an other association trust account may be required.

## Security Deposits

Security deposits are one of the most common causes for complaints regarding property management firms. These deposits may have been held over a long period of time, through a change of management companies and possibly even different property owners. Colorado law and Commission rules and position statements provide guidance for most circumstances.

1. Security deposits must be held in a separate trust account set aside for security deposits. They may not be kept in the same trust account with management funds unless the brokerage meets the less than seven exception mentioned previously.
2. The brokerage is responsible for the security deposit funds and is expected to keep them in a trust account under the principal broker's control. Security deposits may be turned over to the property owner only with tenant authorization in the lease or after written notice to the tenant by first-class mail. This rule ensures that the tenant knows how to seek return of the deposit if the lease is carried out faithfully.
3. If security deposit funds are transferred to a new property manager, tenants must be notified in writing of the change along with instructions for contacting the new manager. The previous property manager must account fully for the funds to the owner and the new property management firm. Failure to provide notice of the transfer of the security deposits to the owner or to a new manager could result in the previous management firm being liable for return of the funds to the tenants.
4. If the property is sold, per the Contract to Buy and Sell, the seller must give the tenant notice of the new owner's name and address so the tenant will know by whom and where her deposit is being held.

Colorado law is definite about the procedures for the return of security deposits. A landlord or property manager, as the agent for the landlord, must return the deposit within one month after the termination of a lease or surrender and acceptance of the premises. The lease may specify a longer period, but it may not be more than 60 days. If there is reason to keep all or part of the deposit, the landlord must provide a statement listing the exact reasons for keeping any part of the deposit. Payment of the balance of the deposit must accompany the list.

If the landlord or property manager, as the agent, does not provide the return of the deposit or the required statement of deductions, he may be liable for damages of triple (treble) the amount wrongfully withheld. The law places the responsibility on the landlord to prove that the deposit was not wrongfully withheld.



The lease should clearly state that the security deposit is not an advance payment of rent. Some municipalities in Colorado require the payment of interest on advance rent payments. Accepting the deposit as the last month's rent could also create a liability to pay interest, as it is advance rent.

### Short-Term Occupancy Agreements

Brokers engaged in property management may collect deposits or advance rental payments for short-term occupancy agreements. These are common in the management of resort condominiums and other resort properties. The Real Estate Commission has taken the position that these funds need to be held in appropriate trust accounts. Since the short-term agreements are usually more like hotel rentals than leases, a real estate license may not be required in order to receive the funds. Some resort management firms have elected to set up separate nonlicensed companies to handle this part of their business. However, if a licensed broker receives them, they must be in a trust account.

### Principal Broker-Owned Properties

Principal brokers may manage properties in which they have a part ownership interest, such as real estate partnerships, joint ventures, and syndications. They may also receive compensation for selling or leasing the property. Brokers who receive compensation for managing properties in which they have ownership interest must maintain a separate trust account for these properties to keep the broker's funds segregated from any other managed property.

### Homeowners Association Management

The Real Estate Commission rules mandate the retention of required records for a period of four years. However, brokers managing common-interest community properties have different record retention requirements.

A principal broker managing a common interest (homeowners) association is generally the **temporary custodian** and trustee for the association records. Such records generally pertain to any budgeting, financial, or ongoing administration of the association business and related operating policies conducted by the broker pursuant to the management agreement. These records belong to the association, not the broker. The Commission requires that all such records be promptly returned to the association upon termination of the broker's employment. A broker may retain file copies at the broker's own expense.

It is recommended that the broker obtain an itemized receipt from any new manager or the association board stating they have received all records and accounts that were previously in the broker's custody. This statement should acknowledge the statutory requirement applicable to the broker for retention of these records for four years and waive any claim against the broker for release of such records in the event of subsequent loss or destruction.

## CLOSING

### Transaction Records

Real Estate Commission Rules and good business practices determine what a principal broker should keep in transaction files. The following lists relate to sales transactions, whether they are residential or commercial. Lease and rental transactions will have similar requirements to retain all of the relevant contracts, agreements, and supporting documents, such as inspection reports.

The following is a list for common records to be retained in both the listing and buyer's brokers' transaction files. Documents, records, and agreements executed by the parties with the closing entity or lender that are not listed below need not be copied or retained in the listing and buyer's brokers' files.

## Sales Files

- Lead-Based Paint Disclosure for residential property built before 1978
- Exclusive Right-to-Buy Listing Contract (buyer's broker only)
- Exclusive Right-to-Sell Listing Contract (listing broker only)
- Brokerage relationships disclosure form—Brokerage Disclosure to Buyer or to FSBO
- Disclosure of compensation for services and income from affiliated entities
- Square footage disclosure for residential property
- The correct Contract to Buy and Sell (residential, commercial, etc.)
- Current marketing/MLS information used in the transaction
- Inspection notice
- Seller's Property Disclosure
- Approved Closing Instructions form—negotiated before the actual date of closing
- Copy of Power of Attorney (show recording data if closed in-house)
- Earnest money promissory note (copy)
- Earnest money receipt held by third-party closing entity
- Buyer's financial information—owner-carry financing
- Rental/occupancy agreement before closing date
- Estimated closing costs/estimated monthly expenses
- Settlement statement (for the party represented or assisted)
- Side agreement/amendment to revise a settlement statement
- Closing entity commission check remittance less earnest money amount, if applicable
- Escrow receipts or collection agreements—continuing after closing
- Accountings for use of advance retainer fees

The following are also required to be retained in the files if the broker personally prepares the document or conducts the closing (in-house without use of a title company), is responsible for the recording of any documents, or both:

- Six-column worksheet for settlement or equivalent form
- Deed (copy showing recording data if closed in-house)
- Deed of trust (copy showing recording data in-house)
- Promissory note (unsigned, marked "*copy*")
- Other legal documents prepared by the broker
- Transaction/tax reports required by government agencies

Broker-associates attending a closing without their employing broker must deliver all closing and related documents to the employing broker immediately following the closing for proper filing. Commission-required records and files must be maintained in good order by the principal brokerage firm for at least four years. Broker-associates may maintain separate personal files and have no requirement for how long the files are to be held.

If the brokerage is a corporation, partnership, or limited liability company, this business entity is responsible for the records. If the entity dissolves, the final acting broker retains personal responsibility for records retention.

If an individual proprietorship dissolves, the records maintenance remains the responsibility of the individual proprietor broker and heirs.

## CLOSING FUNDS

### Good Funds

Commission rules require that **good funds** be available before money is disbursed at a closing. This includes the earnest money held by the brokerage firm. Good funds generally means that a bank will immediately issue cash for whatever form the funds are in. This is obviously not true for a personal, business, or trust account check. Good funds will normally include wire transfers, telephone transfers between accounts in the same bank, cashier's checks, certified checks, teller's checks (from a savings and loan or credit union), and special agreements by which a bank agrees to accept and guarantee a particular check. Even cashier's checks are not foolproof because they could be from a nonexistent bank or otherwise fraudulently created. Many title companies will not take an out-of-town cashier's check without verification, which could include investigating the bank itself. It is the designated broker-associate's responsibility to ensure that the parties appear with the proper form of funds acceptable to the closing agent.

The earnest money, if being held by the brokerage firm, can be transferred to the title company early in order for the title company to have good funds. The broker-associate can bring the earnest money to the closing as a cashier's or teller's check or applicable good funds. The earnest money is going to be credited to the buyer at closing because the buyer has met the requirements of the contract. If a transaction is to be closed by a title insurance company, an attorney, or another closing agent, the broker may transfer funds to the closing agent from the broker's trust account with enough lead time for the check to clear and provide good funds.

## CONFIDENTIAL INFORMATION

The Real Estate Commission provides brokers and brokerage firms with guidance about maintaining confidentiality of various records and files. The advent of *designated brokerage* created the necessity to keep files confidential from others within the brokerage firm as well as anyone outside the firm.

Before designated brokerage, it was common practice to discuss clients' needs and motivations with others within the company, typically in a company sales meeting. Because the company owned the contract and the relationship was with the brokerage firm, there was *imputed knowledge* among all brokers in the firm, and sharing this information was appropriate. Designated brokerage ended that by allowing designated brokers within the firm to each establish a relationship with their own clients. There is no longer imputed knowledge with others in the firm—including the employing broker. This permits all designated brokers within the firm to maintain agency or transaction brokerage relationships with their respective clients without compromising their clients' interests. For example, one designated broker can be the listing broker with seller agency with the seller and another designated broker can have buyer agency with the buyer in the same transaction because confidential information is no longer shared with others in the firm.

Brokerage firms must now take extra care with all common files of client records and communications to protect the confidentiality of the firm's clients. The Commission addresses concerns regarding the types of precautions brokerage firms are expected to take.

# UNIT 1 REVIEW EXAM

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*Complete this review exam and check your answers using the answer key provided.*

1. In a cooperative transaction in which one broker holds an exclusive right-to-sell listing contract and another broker is the buyer's broker,
  - A. the buyer's broker must place the earnest money in a trust account within one business day after acceptance of the offer.
  - B. the listing broker must place the earnest money in a trust account immediately upon receipt of the offer.
  - C. any earnest money promissory note will be the responsibility of the buyer's broker to redeem.
  - D. the buyer's broker must deliver the earnest money deposit to the listing broker immediately upon acceptance.
2. In the event a dispute arises between a seller and a buyer regarding the earnest money, the principal broker
  - A. must return the earnest money to the buyer immediately.
  - B. should notify the Real Estate Commission.
  - C. may interplead the earnest money into court.
  - D. should disburse the earnest money to the seller.
3. In a real estate sale, if the broker places the earnest money deposit in an interest-bearing account, any accrued interest
  - A. belongs to the listing broker.
  - B. belongs to the seller.
  - C. must be agreed to in writing by the principals.
  - D. is shared by the listing and selling brokers.
4. A chronological summary of the cash receipts and disbursements made by the broker, which affect the cash balance of the trust account, is
  - A. the property file.
  - B. the account journal.
  - C. the management file.
  - D. the ledger.
5. Which of the following details receipts and disbursements as they affect a particular property?
  - A. Property file
  - B. Journal
  - C. Management file
  - D. Beneficiary ledger
6. The employing broker should pay the associate brokers' commissions from
  - A. the business operating account.
  - B. the trust account.
  - C. the management account.
  - D. the sales trust account.
7. After the closing of a property transaction, the balance on the beneficiary ledger card
  - A. should be zero.
  - B. might be negative if bills were paid before closing.
  - C. should be the same as the balance reflected on the broker's ledger card.
  - D. should be equal to the check the buyer must bring to closing.
8. The broker must maintain a separate transaction file for each property under a lease, purchase, sale, or exchange of real property. This file must be kept for how many years?
  - A. 4
  - B. 5
  - C. 7
  - D. 12
9. The listing broker must keep a signed copy of which of the following in the property file?
  - A. The good-faith estimate provided by the lender
  - B. The promissory note, if prepared by the broker
  - C. The listing contract, sale contract, and settlement statements
  - D. The loan application and deed of trust

10. A broker managing how many properties must maintain a property management trust account?
  - A. 1
  - B. 2
  - C. 4
  - D. 6
11. A broker must first open a trust account
  - A. before applying for a license.
  - B. before going to work for an employing broker.
  - C. before activating an inactive license.
  - D. when first receiving earnest money for deposit.
12. The document that reports all specific income and expenses associated with a particular owner's property is
  - A. the account journal.
  - B. the beneficiary ledger card.
  - C. the tenant record.
  - D. the property management file.
13. Security deposits collected from tenants in connection with property management must be held in
  - A. the property management trust account.
  - B. the security deposits trust account.
  - C. the operating account until returned.
  - D. the advance rental trust account.
14. In the case of an interest-bearing sales trust account, interest
  - A. earned belongs to the broker.
  - B. may be paid to a nonprofit affordable housing fund.
  - C. earned must be paid to the seller.
  - D. may be applied to closing costs.
15. The Real Estate Commission has the authority to audit a broker's files
  - A. at any time.
  - B. only if written notification is received by the broker at least 24 hours in advance.
  - C. only if the broker has received verbal notification at least 24 hours in advance.
  - D. only after receipt of a verified written complaint.
16. Earnest money received by a listing broker must be
  - A. delivered to the buyer's broker.
  - B. deposited in the sales trust account no later than the third business day following notice of acceptance of the contract.
  - C. deposited in a trust account no later than the third business day following receipt.
  - D. held by the buyer's agent for the buyer.

# ANSWER KEY AND RATIONALES FOR UNIT 1

## REVIEW EXAM

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1. **D** In a cooperative transaction, the listing broker or title company will hold the earnest money. The buyer's broker must deliver the funds immediately after acceptance of the offer.
2. **C** The principal broker in an earnest money dispute may interplead the money to court if no resolution has been found during mediation.
3. **C** Earnest money in an interest-bearing account must be agreed to in writing by all parties. The interest may go to an affordable housing program with notice from the principal broker to the parties.
4. **B** An account journal is a chronological summary of all ledger records in the trust account.
5. **D** The beneficiary ledger accounts for all property details.
6. **A** Commissions to broker-associates may only be paid from the principal broker's operating account.
7. **A** Upon closing, the property ledger card should have a zero balance. A negative balance reflects conversion of funds from one owner to another.
8. **A** The principal broker must retain all records for four years.
9. **C** A listing broker's file should have the listing contract, sales contract, and settlement statements.
10. **A** A principal broker must have a minimum of a management trust account if he manages even one property. If he also holds security deposits, he will need another trust account for security deposits.
11. **D** Principal brokers must have a trust account before receiving trust funds.
12. **B** Beneficiary ledger cards record specific information for each property.
13. **B** Security deposits are held in the security deposit account.
14. **B** Interest may be paid to affordable housing programs.
15. **A** The Commission may audit accounts at any time.
16. **B** Earnest money must be deposited in the listing brokerage or title company trust account within three business days after acceptance of the offer.

## LECTURE OUTLINE

### I. TRUST ACCOUNTS

#### A. Overview

1. Trust accounts are required any time a real estate brokerage firm is going to hold money that belongs to other people.
2. Trust accounts must follow specific rules established by statute and the Real Estate Commission and are subject to audit by the Real Estate Commission.

#### B. Establishing Brokerage Accounts

1. Brokerage firms typically have two types of accounts:
  - a. \_\_\_\_\_, used for running the firm
  - b. \_\_\_\_\_, used to hold money for the benefit of others
2. A principal broker, who is any employing or independent broker who holds money for others, is required to put these funds in a trust account.
3. The principal broker must establish an account prior to receiving money belonging to others.
4. Employees or broker-associates are \_\_\_\_\_ permitted to have trust accounts.
5. If the principal broker is not holding money belonging to others, no trust accounts are required.
  - a. If the principal broker chooses to have a title company hold the funds, the principal broker will still be responsible for making sure the funds are in safe and proper keeping.
6. Principal brokers who have trust accounts must follow specific rules. The principal broker
  - a. must use a \_\_\_\_\_ of accuracy and care;
  - b. is personally responsible for the funds in the trust account;
  - c. is subject to commission audit \_\_\_\_\_; and
  - d. should establish the trust account \_\_\_\_\_ receiving money belonging to others.

#### C. Operating a Trust Account

1. Principal brokers are responsible for supervising their trust accounts.
2. Principal brokers must be able to withdraw funds without a cosigner.
3. The trust account \_\_\_\_\_ funds or any funds belonging to employed broker-associates.
  - a. Employed brokers' commissions are paid from the broker's \_\_\_\_\_.



4. Care must be taken to not commingle the broker's funds with trust funds.

- a. The account may contain \_\_\_\_\_ to open and operate the account.
- b. Commissions or other funds \_\_\_\_\_ and belong to the broker must be removed from trust account \_\_\_\_\_.

#### **D. How Many Trust Accounts Does a Broker Need?**

1. A broker needs enough trust accounts to assure that funds will not be \_\_\_\_\_.
2. The Commission requires the following types of separate accounts when the broker is holding funds for others:
  - a. \_\_\_\_\_ trust account—for money held in connection with sales transactions pending closing, which is also known as \_\_\_\_\_
  - b. \_\_\_\_\_ trust account—for money held in connection with property management services
  - c. \_\_\_\_\_ trust account—for refundable security deposits collected from tenants for lease and rental units under management by the broker
  - d. Advance rental—for rental money collected in advance, especially for short-term rentals as experienced in resort and vacation rentals
  - e. Owners' association trust account—for funds held on behalf of condominium or planned community associations. Use a separate account for each association and identify the account with the tax identification number of each association.

#### **E. Requirements for a Trust Account**

1. Trust accounts must be in a bank or appropriate institution located in \_\_\_\_\_.
2. They must be insured by a government agency, such as the \_\_\_\_\_.
3. Trust accounts can be held in a \_\_\_\_\_ that is insured, such as a bank, savings and loan association, or credit union.
4. Trust accounts must follow specific requirements of the Commission.
  - a. The brokerage firm name and \_\_\_\_\_ personal name must be on account records.
5. The bank must recognize that the account is a trust account.
  - a. Checks and \_\_\_\_\_ slips must indicate that it is a trust account.
  - b. Branch offices do not need trust accounts separate from main office unless they maintain separate bookkeeping systems as well.

## F. Interest-Bearing Trust Accounts

1. The parties must agree if the account is to be interest bearing.
  - a. Details of interest, fees, penalties, and disposition of interest are negotiated and \_\_\_\_\_.
  - b. These funds are placed in a trust account \_\_\_\_\_ from all other funds held by the broker.
2. Exception
  - a. The broker's sales trust account may be an interest-bearing account if the interest benefits an \_\_\_\_\_.
    - (1) Colorado Association of REALTORS® Foundation (CRF)
  - b. The brokerage must have a sign in the office indicating participation in this program.
    - (1) The seller and buyer will approve the transfer in the Contract to Buy and Sell.

## II. EARNEST MONEY

### A. Earnest Money Deposits

1. Earnest money deposits are typically payable to the \_\_\_\_\_ and presented with the contract offer.
2. The type of the \_\_\_\_\_ (such as check or promissory note) is identified in the Contract to Buy and Sell.
  - a. Earnest money is anything the seller will \_\_\_\_\_.
3. Checks must be deposited not later than the \_\_\_\_\_ following notice of \_\_\_\_\_ of the offer.
4. Earnest money can be held in the trust account of a \_\_\_\_\_, such as a title company, with the permission of the parties.
5. The holder of the earnest money is identified in the contract and is often shown in the MLS. Listing brokers must advise buyer's brokers if the earnest money is to be held by a \_\_\_\_\_.
6. If a contract \_\_\_\_\_ under a provision of the contract or ends due to an undisputed default of either party, the broker is required to disburse the funds to the proper party without delay.
7. If there is a dispute regarding disbursement of the earnest money, broker may
  - a. hold the funds until it is resolved;
  - b. interplead the funds to the court if the dispute is not resolved; and
  - c. deliver notice to the parties of the intent to disburse funds to the buyer if no action is taken within 120 calendar days of notice.

**B. Earnest Money Promissory Note**

1. A note is a reasonable alternative when the \_\_\_\_\_ has limited funds available when the offer is submitted.
2. Notes are made payable to the \_\_\_\_\_ and must be identified with the due date specified in the Contract to Buy and Sell.
3. The due date must be before closing in time for the funds to be \_\_\_\_\_ at closing.
4. If the note cannot be collected when due, the \_\_\_\_\_ must inform the seller immediately and is responsible for the collection of the funds.
  - a. The seller can choose to declare the contract in default or agree to \_\_\_\_\_ the contract.
  - b. Costs of collecting the promissory note are the responsibility of the buyer.

**III. RECORDKEEPING****A. Records and Recordkeeping Systems**

1. Principal brokers must have trust account records that include the following:
  - a. Account journal of all cash receipts/disbursements—a \_\_\_\_\_ of all activity in the account
  - b. \_\_\_\_\_ account system—records with specific details regarding the parties for each transaction
  - c. Broker ledger card—for funds \_\_\_\_\_
  - d. Bank reconciliation records
    - (1) Trust accounts must be reconciled \_\_\_\_\_ that there is activity in the account.
    - (2) All disbursements and receipts must be supported by appropriate documentation in the transaction file.
2. The transaction file will include all support documents for any funds held in the trust account. At minimum, these records include copies of the following documents:
  - a. Contract, \_\_\_\_\_, Seller's Property Disclosure, listing or buyer representation agreement
  - b. Copies of the \_\_\_\_\_ and other closing documents signed at closing for the parties they represented
  - c. Copies of other documents or checks (at the principal broker's option)

3. Employing brokers are responsible for making sure that they have a complete file of all required documents and agreements made during the transaction.
  - a. Employed brokers are required to return files to the employing broker for review and to file \_\_\_\_\_ after the closing.
4. Brokers must maintain required records for a minimum of \_\_\_\_\_ years.
5. The \_\_\_\_\_ must have the exclusive right-to-sell listing contract in their file and the \_\_\_\_\_ agreement or brokerage disclosure must be in the selling brokerage firm's file.
  - a. Both brokers' files are to have copies of the rest of the required documents.
6. Most employing brokers will not disburse commission checks until the file is complete.
7. Sole proprietors are responsible for retaining their records for four years, even if they leave the business entirely or close their office to join another brokerage firm. (If deceased, the heirs are responsible for records retention.)

## **B. Safeguards**

1. \_\_\_\_\_ (monthly)
2. Separation of duties
3. Outside audits
4. Real estate commission assistance

## **C. Commingling/Conversion of Trust Account Funds**

1. \_\_\_\_\_ is the improper mixing of operating account funds with trust account funds.
  - a. Not removing earned commissions or fees from the trust account \_\_\_\_\_ is an example of commingling.
2. The illegal practice of \_\_\_\_\_ is the use of one party's funds for the benefit of another party.
  - a. Paying bills for a property owner whose \_\_\_\_\_ does not have sufficient funds, even though the check will clear the bank, is an example of this.
3. An owner's ledger card can have \_\_\_\_\_ at times—this is not commingling or conversion. However, a negative balance for an owner is most likely an example of conversion.
4. Brokers are responsible for accurate accounting for all funds held in their trust accounts.
5. Business funds including payroll taxes or other employee withholdings do not belong in the real estate trust accounts.

## D. Property Management

### 1. Accounts

- a. The management account holds funds belonging to the \_\_\_\_\_ and it is used to manage the property.
  - (1) Deposits including rents or other income and payments of bills, including the broker's fee, flow through this account.
- b. Security deposits must be held in an account separate from the owner's account because the funds belong to the \_\_\_\_\_.
- c. Property management-related rents must be deposited into the appropriate trust account no later than \_\_\_\_\_ days following receipt of the money.
- d. Principal brokers who hold earnest money and manage properties must have the following:
  - (1) A sales trust account to hold \_\_\_\_\_
  - (2) At least one property management account for owners' funds
  - (3) At least one \_\_\_\_\_ trust account for tenants' funds
  - (4) A broker can have an unlimited number of deposits for each type of funds in the above accounts—separate accounting using the \_\_\_\_\_ identifies the individual transactions and properties.

### 2. Security deposits

- a. The lease and management agreement specify who holds the deposit—owner or broker—as tenants must know who has their money.
- b. The broker can turn the deposit over to the owner
  - (1) with written authorization of the tenant;
  - (2) if the \_\_\_\_\_ calls for it; or
  - (3) after notifying the tenant in writing that the owner is holding the deposit.
- c. The broker is responsible for security deposits and \_\_\_\_\_ if no longer managing the property and advise tenants how to contact the new manager.
- d. The security deposit must be returned in full or an accounting of the reason the deposit was kept must be sent to the tenant within one month or within \_\_\_\_\_ if the lease calls for it.

3. Short-term occupancy funds and advance rental payments are not security deposits and are held in management trust accounts.
4. Brokers who receive compensation for managing a property in which they have an ownership interest are required to use a separate management account for those properties.
5. Homeowners association records belong to the association, not the brokerage firm. It is required by the Commission that all such records be promptly returned to the association upon termination of the broker's employment. A broker may retain file copies at the \_\_\_\_\_.

#### **IV. CLOSING FUNDS**

##### **A. Good funds must be available for closing.**

1. Good funds include
  - a. wire transfers;
  - b. cashier's checks; and
  - c. teller's checks (savings and loan or credit union).
2. Good funds are NOT personal checks or company checks.

##### **B. Clients must bring their funds in good funds.**

1. A check made payable \_\_\_\_\_ is recommended.

##### **C. The broker may deliver earnest money to the closing entity prior to closing.**

1. The broker gets a receipt for earnest money—closing instructions or Earnest Money Receipt form.

#### **V. CONFIDENTIAL INFORMATION**

##### **A. Protect your clients.**

1. Clients' confidential information, such as \_\_\_\_\_ factors or the willingness to consider different price or terms, must be filed to protect the clients' information.
2. Confidential information must be protected from \_\_\_\_\_ within the firm.
3. \_\_\_\_\_ eliminates imputed knowledge within the firm; other brokers are not presumed to have access to confidential information.
4. Commission rules discuss policies necessary to protect information within the firm.



# Colorado Closings and Settlement

Colorado real estate brokers are obligated to provide the party they represent with a settlement statement. New licensees should have competency in closing issues, including the following:

- The basic skills required to properly close a real estate transaction
- An understanding of the broker-associates' and employing broker's responsibilities, from the sales contract through after the closing
- The knowledge required to account for all funds received and disbursed
- A comprehensive review of the legal documents the broker prepares

Here we will review the basic concepts needed to close a real estate transaction. Known as *closing* or *settlement*, this process completes the financial transaction between a buyer and seller. It also ensures the necessary documents are prepared to carry out the transfer of ownership.

**Important:** By Colorado law, designated brokers are responsible for the settlement statements for the party they represent.

- Unit 1** Closings: The Big Picture
- Unit 2** How Loans Affect the Buyer and Seller
- Unit 3** The New Loan Closing
- Unit 4** Final Exam Study Guide





# UNIT 1

## Closings: The Big Picture

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Discuss the broker's role and responsibilities in a closing.
- › Demonstrate accounting for typical buyer, seller, and broker closing items.
- › Calculate prorations for expenses between the seller and the buyer.

### KEY TERMS

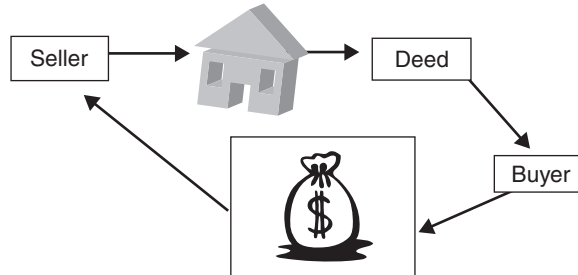
buyer's broker	designated broker	loan assumption
broker's trust account	documentary fee	mortgage insurance
certificate of taxes due	escrow account	notary
closing	hazard insurance	proration
credit	homeowners association	recording
debit	lender reserve (impound)	settlement statement
deed of trust (trust deed)	account	six-column closing
deficit closing	listing broker	worksheet

### CLOSING A REAL ESTATE TRANSACTION

#### The Big Picture

Closing day is an exciting day for all involved. The seller will convey title to the property and get a check for equity. The buyer is finally going to own the property and the brokers will get a paycheck. The financial piece of the real estate transaction is the final step the real estate broker is responsible for in order to collect the commission that is owed the brokerage.

The requirements of the closing are created in the Contract to Buy and Sell. The seller, in exchange for the money the buyer brings, will convey title by giving the buyer a deed. The closing would be very simple if there were no liens, taxes, or other charges. The buyer would just hand the seller a check for the sales price and the seller would give the buyer the deed to the property.



Even if the seller has no liens or debt against the property and the buyer is paying in cash, there will be a minimum number of charges, called *entries*, that have to be taken care of at closing. These entries are called **debits** (money owed) and **credits** (money received).

### A Simple Cash Closing

One of the entries the seller will be asked to pay for is title insurance for the buyer.

**Remember:** This is standard in the Contract to Buy and Sell. Additionally, the seller will need to pay a share of the tax bill for the current year and may owe some water or other fees. The seller also typically pays the broker's fee and the fee to notarize the signature on the warranty deed. All of these are amounts that are owed and will be debits to the seller.

### The Seller's Side of Closing

Seller will receive the sales price	+ \$ Credit to seller
Seller will owe broker and notary fees and a prorated share of water	– \$ Debit what seller owes +/– based on when the bill is owed (advance or arrears)
Taxes for the current year—always paid in arrears so the seller will owe the buyer	– \$ Debit the seller portion of the year
<b>Remaining balance of money to seller</b>	<b>The check the seller takes with them—called net proceeds</b>

### The Buyer's Side of Closing

The buyer will pay money for the tax certificate, documentary fee, and recording the deed, which will be a debit to them and credit to the broker. The broker will write the checks to pay the bill for the buyer. The buyer may owe the seller for water (if the bill was paid in advance) but should receive from the seller the seller's portion of taxes for the current year. These prorations are shared between the buyer and seller depending upon when the bill is due. For example, taxes, which are paid in arrears in Colorado, will always be a debit to the seller, who owes the bill, and a credit to the buyer, who will pay the bill when it comes due next year.

The buyer will receive the deed in exchange for the money the buyer brings—in this case, cash.

Buyer will receive deed but must give cash	— \$ Debit sales price from buyer
Buyer will owe tax certificate, recording, and notary fee	— \$ Debit from buyer
Prorated share of water	Debit or credit based on whether the bill is paid in advance or arrears
<b>Total is the balance of the cash the buyer will need to bring to closing</b>	<b>Good funds check from buyer</b>

Closing is simply the seller paying the bills so the property can be conveyed according to the Contract to Buy and Sell. Additionally, the broker or title closer will need to determine the total amount the buyer will need to bring to closing in order to meet the bills and pay the seller the agreed sales price.

## UNDERSTANDING THE REAL ESTATE SETTLEMENT

The buyer and seller negotiate a purchase contract that includes various items to be charged at the closing table and identifies various responsibilities for each party before the sale of the property can be finalized. The transaction may involve a variety of parties and service providers, including the following:

- Seller
- Buyer
- Designated listing broker (working with the seller)
- Designated buyer’s broker (working with the buyer)
- Current lender, new lender, or both
- Title insurance companies, attorneys, appraisers, surveyors, inspectors, etc.

The designated brokers working with the seller and buyer must ensure that all parties meet their obligations and are compensated as specified in the contract.

To the average buyer and seller, the closing is a blizzard of paperwork they may or may not understand but must sign, an overwhelming amount of numbers, and a large check they either bring to or take away from the closing. They rely on their real estate professional to guide and educate them through the contract and closing process. Even more importantly, they rely on their real estate broker to ensure the transaction is closed properly.

### What Happens at Closing?

At a real estate closing, the brokers and the closing company have the duty to ensure that title to the real estate is correctly passed from the seller to the buyer. The buyer and seller must meet their obligations as set forth in the Contract to Buy and Sell. The seller may have to pay off prior obligations and liens. The buyer will probably get a new loan or assume (take over) an existing loan now held by the seller. The brokers’ and closing company’s responsibilities include ensuring that the correct paperwork is drafted, signed by the appropriate parties, and, often, recorded with the County Clerk and Recorder. The brokers must verify that each party has paid for any services they agreed to in the contract and the payment for the property is in place before the deed is delivered and accepted.

Most closings are handled by title insurance companies in Colorado, but the Colorado Real Estate Commission holds licensed brokers responsible for either performing the closing or checking it thoroughly before the actual transfer of title. Every closing is different, but they all involve a lot of very specific paperwork and financial accounting.

## **Listing Brokerage and Listing Broker**

The listing brokerage firm and listing broker have an overall responsibility to see that a proper closing happens. The designated buyer's broker should deliver earnest money to the listing broker, either with the offer or immediately upon acceptance of the offer, when it becomes an executory contract. The listing broker will have three business days to deposit the earnest money into an escrow account belonging to either the brokerage firm or the title company.

## **Designated Broker Responsibilities**

The broker designated by an employing broker to assist or represent the seller or buyer is responsible for the proper closing of the transaction and must sign and be responsible for a settlement statement as it applies to the party with whom that broker has a *brokerage relationship*. This means that a broker-associate who has been appointed by the employing broker in writing or by written company policy as the designated broker for the seller or buyer is personally responsible for the accuracy and completeness of the seller's or buyer's closing documents and finances. Thus, the designated listing broker is responsible for the overall closing and the seller's settlement statement and the designated buyer's broker is responsible for the buyer's settlement statement.

License law requires that settlement statements be delivered to the parties at the time of delivery and acceptance of the title at closing. The Commission's Settlement Statement form is designed to meet this requirement. Other forms prepared by a title company or other closing entity are acceptable, but they must meet the minimum requirements of the Commission rules.

## ***What if a Broker Can't Make it to the Closing?***

Brokers for both parties are expected to attend the closing. If they cannot attend, they may have their employing broker designate another broker to attend in their place. The employing broker, the original broker, and the newly appointed broker will all share the responsibility of the closing being accurate.

## **Title Company or Other Closing Entity**

The parties to the contract may, and most often do, engage a company other than the listing brokerage to carry out the settlement services. The Real Estate Commission has approved a form to use in setting up this relationship. The Closing Instructions document reproduced in Figure 1.1 identifies and allocates the proper responsibilities. The document can be completed before or with the delivery of the earnest money.

The closing company then becomes responsible to the parties for their work in preparing the paperwork. The Real Estate Commission rules do not, however, permit the brokers to escape responsibility. The designated brokers are still responsible for checking the closing company's work on behalf of the party they represent.

The Closing Instructions form also addresses the preparation of documents by the closing company, wire and other frauds, and FIRPTA and Colorado withholding.

In the past, title companies acted as a scrivener for real estate brokers in the preparation of real estate documents. A scrivener is someone who writes a document, such as a deed in this case, for another party, in return for a fee. The Closing Instructions form authorizes the title company to prepare three different documents—the deed, the bill of sale, and the seller and buyer closing statements.

**Figure 1.1: Closing Instructions**

1 The printed portions of this form, except differentiated additions, have been approved by the Colorado Real Estate Commission.  
 2 (CL8-5-19) (Mandatory 7-19)  
 3  
 4 **THIS FORM HAS IMPORTANT LEGAL CONSEQUENCES AND THE PARTIES SHOULD CONSULT LEGAL AND TAX OR**  
 5 **OTHER COUNSEL BEFORE SIGNING.**  
 6

7 **CLOSING INSTRUCTIONS**

8  
 9 Date: \_\_\_\_\_  
 10

11 **1. PARTIES, PROPERTY.** \_\_\_\_\_, (Seller),  
 12 and \_\_\_\_\_,  
 13 (Buyer), engage \_\_\_\_\_, (Closing  
 14 Company), who agrees to provide closing and settlement services in connection with the Closing of the transaction for the sale and  
 15 purchase of the Property  
 16 known as No. \_\_\_\_\_,  
 17 Street Address City State Zip  
 18 and more fully described in the Contract to Buy and Sell Real Estate, dated \_\_\_\_\_, including any  
 19 counterproposals and amendments (Contract). The Buyer's lender may enter into separate closing instructions with the Closing  
 20 Company regarding the closing of the Buyer's loan. All terms of the Contract are incorporated herein by reference. In the event of  
 21 any conflict between this Agreement and the Contract, this Agreement controls, subject to subsequent amendments to the Contract  
 22 or this Agreement.

23 **2. TITLE COMMITMENT, EXCEPTIONS AND POLICY.** Closing Company ☐ **Agrees** ☐ **Does Not** agree that: upon  
 24 completion of a satisfactory title search and examination, it will furnish a Title Insurance Commitment; and it will issue a Title  
 25 Insurance Policy provided that all requirements have been fulfilled. Closing Company ☐ **Agrees** ☐ **Does Not** agree to furnish  
 26 copies of Exceptions.

27 **3. INFORMATION, CLOSING, RECORDING.** Closing Company is authorized to obtain any information necessary for  
 28 the Closing. Closing Company agrees to, deliver and record all documents required or customarily recorded, and disburse all funds  
 29 pursuant to the Contract that are necessary to carry out the terms and conditions of the Contract.

30 **4. PREPARATION OF DOCUMENTS.** The Closing Company will prepare the necessary documents to carry out the terms  
 31 and conditions of the Contract to include:

32 **4.1. Deed.** If the deed required in the Contract is a special warranty deed, general warranty deed, bargain and sale deed  
 33 (excluding a personal representative's or trustee's deed) or a quit claim deed, the deed will be prepared in accordance with the  
 34 Contract by the Closing Company. However, if the Contract requires a different form of deed (e.g.: personal representative's deed  
 35 or trustee's deed) or requires that the special warranty deed or general warranty deed list exceptions other than the "statutory  
 36 exceptions" as defined in §38-30-113(5)(a), C.R.S., then the Buyer or Seller must provide the deed or written instructions for  
 37 preparation of the deed to the Closing Company for Closing. For any Buyer or Seller provided deed or written instructions for  
 38 preparation of the deed that requires a list of exceptions other than the "statutory exceptions", the Buyer and Seller will hold the  
 39 Closing Company harmless for any causes of action arising out of the use of such deed. The parties acknowledge that the real  
 40 estate broker working with either the Buyer or the Seller is not responsible for reviewing or approving any deed not prepared by  
 41 the real estate broker.

42 **4.2. Bill of Sale.** If the transaction includes the sale of personal property (i.e. within the Contract or a Personal Property  
 43 Agreement) from the Seller to the Buyer, Seller and Buyer authorize Closing Company to prepare the bill of sale conveying the  
 44 personal property from the Seller to the Buyer as their scrivener. The Buyer and Seller understand that the bill of sale is a legal  
 45 document and it is recommended that it be reviewed and approved by their respective attorneys.

46 **4.3. Closing Statement.** Closing Company will prepare and deliver accurate, complete and detailed closing statements  
 47 to Buyer, Seller and the real estate brokers working with Buyer and Seller. Closing Statements will be prepared in accordance with  
 48 the Contract and written instructions from the Buyer, Seller, lender or real estate brokers so long as such written instructions are  
 49 not contrary to the Contract. If the written instructions are contrary to the Contract, the Buyer and Seller must execute an  
 50 Agreement to Amend/Extend Contract.

51 **5. CLOSING FEE.** Closing Company will receive a fee of \$ \_\_\_\_\_ for providing closing and  
 52 settlement services (Closing Fee).

**Figure 1.1: Closing Instructions (continued)**

- 53 **6. RELEASE, DISBURSEMENT.** Closing Company is not authorized to release any signed documents or things of value  
54 prior to receipt and disbursement of Good Funds, except as provided in §§ 10, 11 and 12.
- 55 **7. DISBURSER.** Closing Company must disburse all funds, including real estate commissions, except those funds as may be  
56 separately disclosed in writing to Buyer and Seller by Closing Company or Buyer's lender on or before Closing. All parties agree  
57 that no one other than the disbursing can assure that payoff of loans and other disbursements will actually be made.
- 58 **8. SELLER'S NET PROCEEDS.** Seller will receive the net proceeds of Closing as indicated: ☐ **Cashier's Check**, at Seller's  
59 expense ☐ **Funds Electronically Transferred** (wire transfer) to an account specified by Seller, at Seller's expense ☐ **Closing**  
60 **Company's** trust account check.
- 61 **9. WIRE AND OTHER FRAUDS.** Wire and other frauds occur in real estate transactions. Anytime Buyer or Seller is  
62 supplying confidential information, such as social security numbers, bank account numbers, transferring or receiving funds, Buyer  
63 and Seller should provide the information in person or in another secure manner.
- 64 **10. FAILURE OF CLOSING.** If Closing or disbursement does not occur on or before Closing Date set forth in the Contract,  
65 Closing Company, except as provided herein, is authorized and agrees to return all documents, monies and things of value to the  
66 depositing party, upon which Closing Company will be relieved from any further duty, responsibility or liability in connection  
67 with these Closing Instructions. In addition, any promissory note, deed of trust or other evidence of indebtedness signed by Buyer  
68 will be voided by Closing Company, with the originals returned to Buyer and a copy to Buyer's lender.
- 69 **11. RETURN OF EARNEST MONEY.** Except as otherwise provided in § 12 (Earnest Money Dispute), if the Earnest Money  
70 is being held by Closing Company and has not already been returned following receipt of a Notice to Terminate or other written  
71 notice of termination, Closing Company must release the Earnest Money as directed by written mutual instructions from the Buyer  
72 and the Seller. Such release of Earnest Money must be made within five days of Closing Company's receipt of the written mutual  
73 instructions signed by both Buyer and Seller, provided the Earnest Money check has cleared.
- 74 **12. EARNEST MONEY DISPUTE.** In the event of any controversy regarding the Earnest Money (notwithstanding any  
75 termination of the Contract), provided Closing Company is holding the Earnest Money, Closing Company is not required to take  
76 any action. Closing Company, at its option and sole subjective discretion, may: (1) await any proceeding, (2) interplead all parties  
77 and deposit Earnest Money into a court of competent jurisdiction and recover court costs and reasonable attorney and legal fees, or  
78 (3) provide notice to Buyer and Seller that unless Closing Company receives a copy of a Summons and Complaint or Claim  
79 (between Buyer and Seller) containing the case number of the lawsuit (Lawsuit) within one hundred twenty days of Closing  
80 Company's notice to the parties, Closing Company is authorized to return the Earnest Money to Buyer. In the event Closing  
81 Company does receive a copy of the Lawsuit, and has not interpleaded the monies at the time of any Order, Closing Company must  
82 disburse the Earnest Money pursuant to the Order of the Court.
- 83 **13. SUBSEQUENT AMENDMENTS.** Any amendments to, or termination of, these Closing Instructions must be in writing  
84 and signed by Buyer, Seller and Closing Company.
- 85 **14. CHANGE IN OWNERSHIP OF WATER WELL.** Within sixty days after Closing, Closing Company will submit any  
86 required Change in Ownership form or registration of existing well form to the Division of Water Resources in the Department of  
87 Natural Resources (Division), with as much information as is available. Closing Company is not liable for delaying Closing to  
88 ensure Buyer completes any required form.
- 89 **15. FIRPTA AND COLORADO WITHHOLDING.**
- 90 **15.1. FIRPTA.** Seller agrees to cooperate with Buyer and Closing Company to provide any reasonably requested  
91 documents to determine Seller's foreign person status. If withholding is required, Seller authorizes Closing Company to withhold  
92 any required amount from Seller's proceeds and remit it to the Internal Revenue Service.
- 93 **15.2. Colorado Withholding.** Seller agrees to cooperate with Closing Company to provide any reasonably requested  
94 documents to determine Seller's status. If withholding is required under Colorado law, Seller authorizes Closing Company to  
95 withhold any required amount from Seller's proceeds and remit it to the Colorado Department of Revenue.
- 96 **16. ADDITIONAL PROVISIONS.** (The following additional provisions have not been approved by the Colorado Real Estate  
97 Commission.)  
98  
99  
100
- 101 **17. COUNTERPARTS.** This document may be executed by each party, separately, and when each party has executed a copy,  
102 such copies taken together are deemed to be a full and complete contract between the parties.
- 103 **18. BROKER'S COPIES.** Closing Company must provide, to each real estate broker in this transaction, copies of all signed  
104 documents that such real estate brokers are required to maintain pursuant to the rules of the Colorado Real Estate Commission.

**Figure 1.1: Closing Instructions (continued)**

105
106

Closing Company is authorized by both Buyer and Seller to deliver their respective Closing Statement to one or both real estate brokers involved in the transaction.

107

**19. NOTICE, DELIVERY AND CHOICE OF LAW.**

108
109

**19.1. Physical Delivery and Notice.** Any document, or notice to another party must be in writing, except as provided in §19.2 and is effective when physically received by such party.

110
111

**19.2. Electronic Notice.** As an alternative to physical delivery, any notice, may be delivered in electronic form to another party at the electronic address of the recipient by facsimile, email or \_\_\_\_\_.

112
113
114

**19.3. Electronic Delivery.** Electronic Delivery of documents and notice may be delivered by: (1) email at the email address of the recipient, (2) a link or access to a website or server, provided the recipient receives the information necessary to access the documents or (3) facsimile at the facsimile number (Fax No.) of the recipient.

115
116
117

**19.4. Choice of Law.** These Closing Instructions and all disputes arising hereunder are governed by and construed in accordance with the laws of the State of Colorado that would be applicable to Colorado residents who sign a contract in Colorado for real property located in Colorado.

Buyer's Name: _____		Buyer's Name: _____	
_____		_____	
Buyer's Signature	Date	Buyer's Signature	Date
Address: _____		Address: _____	
Phone No.: _____		Phone No.: _____	
Fax No.: _____		Fax No.: _____	
Email Address: _____		Email Address: _____	
Seller's Name: _____		Seller's Name: _____	
_____		_____	
Seller's Signature	Date	Seller's Signature	Date
Address: _____		Address: _____	
Phone No.: _____		Phone No.: _____	
Fax No.: _____		Fax No.: _____	
Email Address: _____		Email Address: _____	
Closing Company's Name: _____			
_____			
Authorized Signature		Title	Date
Address: _____		_____	
Phone No.: _____		_____	
Fax No.: _____		_____	
Email Address: _____		_____	



## DEBITS AND CREDITS

The six-column Settlement Closing worksheet and the Closing Statement use the terms *debit* (for items that are owed) and *credit* (for items or amounts received) for the buyer and seller. They are given special meanings in real estate settlement that is not quite the same as in standard bookkeeping practice. The following paragraphs explain how you should use these terms.

### Debit: Items Owed

The word *debit* means a bill due from or charged to either the buyer or seller on the day of closing.

A debit is bad (a disadvantage) for that party's bottom line on closing day:

- A debit for the seller reduces the amount of money the seller takes away from closing.
- A debit for the buyer will increase the amount of money the buyer will bring.

A seller debit decreases the check the seller will receive at closing.

Typical seller debits—bills—include the following:

- Owner's title insurance—paid for by the seller and given to the buyer
- Unpaid property taxes for the preceding year
- Prorated property taxes for the portion of the current year the seller owes
- Notary fee for the warranty deed
- Broker's commission—as agreed to in the listing agreement
- Prorated water and homeowners association (HOA) dues, if paid in arrears
- Loans of the seller that are assumed by the buyer\*
- Seller's loans that have to be paid off\*
- New seller-carry loans (the amount of the loan the seller carries for the buyer at closing is money the seller will not receive at closing)\*
- Closing fees as determined by the Contract to Buy and Sell

\* **Note:** If the seller is involved in the loan, it will be a seller debit.

A buyer debit increases the amount of money the buyer must bring to closing.

Typical buyer debits—items owed—include the following:

- Selling price of the property as determined by the contract
- Loan closing costs as agreed to in the contract in conjunction with the lender
- Premium for new **hazard insurance**
- Recording fees for the warranty deed and deed of trust
- Documentary fee based on the sales price
- Notary fee for documents the buyer signs that require notarizing, such as the note and deed of trust
- Closing fees
- Tax certificate
- Prorated water and HOA dues, if paid in advance

## Credit: Amounts Received

The word *credit* means money received by either the buyer or the seller on the day of closing.

A credit is good (an advantage) for that party's bottom line on closing day:

- A credit to the seller increases the amount of money the seller will receive.
- A credit to the buyer reduces the amount of money the buyer must bring to closing.

A seller credit—amount received—makes the seller's check on closing day larger.

Typical seller credits include the following:

- Selling price of the property as determined by the contract
- Proration of bills paid in advance (already paid) by the seller, such as homeowners and water fees

A buyer credit helps the buyer pay for property without bringing more money to the closing.

Typical buyer credits include the following:

- Earnest money already deposited by the buyer and held by the listing broker or closing company—the listing broker will be responsible for making sure this money is brought to closing if it is in the listing company escrow account
- Security deposits transferred from a seller on an investment property
- Current year's property taxes (a prorated amount paid by the seller to the buyer, for the amount of time the seller lived in the property)
- The amount of any loans assumed by the buyer or any new loans created as part of the purchase—all loans are a credit to the buyer to pay off many of the bills at closing

**Remember:** Debit and credit always relate to the seller's and buyer's money at closing.

- A debit—an item owed—is a disadvantage for that party's money at closing.
- A credit—an amount received—is an advantage for that party's money at closing.

The debit and credit columns for the broker refer to the broker's escrow account or ledger card for that particular transaction and have different meanings than they do for the buyer or seller.

A broker debit is money to be deposited into the broker escrow account.

The two common broker debits/deposits are

- buyer's earnest money, which will be credited to the buyer at closing; and
- net loan proceeds, a deposit of funds from the lender when the buyer uses a new loan.

A broker credit represents money taken out of the broker's escrow account to pay a bill. Think of it as a check the broker will write to pay a bill for either the seller or the buyer. Remember, the broker will charge the amount of the bill as a debit to the responsible party.

Typical bills the broker will pay on behalf of the seller or buyer include

- title insurance;
- payoff to a lender; and
- recording, documentary, and notary fees.

Broker debit = deposit (money in)

Broker credit = check (money out)

## Closing Forms

The buyer and seller will each receive a settlement statement at the closing, which will reflect their debits and credits only. The individual settlement statements are created from the six-column closing worksheet. The listing brokerage and listing broker are responsible for the overall closing. The designated brokers are responsible for the settlement statements for the party they represent. This means the listing broker will be responsible for the overall closing and the seller's settlement statement, but the designated buyer's broker will be responsible for making sure the figures on the buyer's settlement statement are correct.

It is important to remember that all the forms, including the closing worksheet and settlement statements, reflect only what happens at the closing table—the money in and out on that day. Items paid for before or after the closing will not be reflected in the money the party brings or receives. For example, if the buyer assumes the seller's loan, the seller will be given a debit for that amount (since the seller will not be receiving those funds at the end of the closing), and the buyer will be given a credit (as the buyer will not have to bring money to cover the loan being assumed).

### WORKSHEET FOR CLOSING STATEMENT

PROPERTY ADDRESS \_\_\_\_\_

SELLER \_\_\_\_\_ BUYER \_\_\_\_\_

SETTLEMENT DATE \_\_\_\_\_ DATE OF PRORATION \_\_\_\_\_

LEGAL DESCRIPTION:

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Purchase Price						
2. Deposit (Earnest Money) Paid to						
3. Principal amount of new 1st Loan Payable to						
4. Principal amount of new 2nd Loan Payable to						
5. 1st Loan Payoff to						
6. 2nd Loan Payoff to						
7. Taxes for Preceding Year(s)						
8. Taxes for Current Year						
9. Personal Property Tax						
10. Transaction Fee						
11. Loan Origination Fee						
12. Loan Discount Fee						
13. Appraisal Fee						

A broker preparing to close at the office would use the six-column worksheet to determine all the debits and credits for each of the three parties. The broker column is used to keep track of bills the broker needs to pay for the responsible party or to note the earnest money that will be a credit to the buyer. Once the closing worksheet is complete, separate closing statements are created for the buyer and the seller. At closing, only the individual closing statements will be reviewed and signed. More typically, the closing statements are created by the title company closer and reviewed before closing by each designated broker.

## Closing Statement for the Seller or Buyer

One statement is created for each party or side of the closing. No closing statement is created for the broker column. This column represents checks (credit) the closer or broker will write to pay the bills for the responsible party or deposits (debit) the broker receives, so no separate statement is needed.

The printed portions of this form, except differentiated additions, have been approved by the Colorado Real Estate Commission. (SS60-6-16)(Mandatory 1-17)	
<input type="checkbox"/> ESTIMATE	<input type="checkbox"/> FINAL

### CLOSING STATEMENT

☐ SELLER'S   ☐ BUYER'S

PROPERTY ADDRESS \_\_\_\_\_

SELLER \_\_\_\_\_ BUYER \_\_\_\_\_

SETTLEMENT DATE \_\_\_\_\_ DATE OF PROPATION \_\_\_\_\_

LEGAL DESCRIPTION:

	Debit	Credit
1. Purchase Price		
2. Deposit (Earnest Money) Paid to		
3. Principal amount of new 1st Loan Payable to		
4. Principal amount of new 2nd Loan Payable to		
5. 1st Loan Payoff to		
6. 2nd Loan Payoff to		

## UNDERSTANDING THE SIX-COLUMN CLOSING WORKSHEET

The purpose of the closing is to finalize the sales contract as well as fulfill the broker's statutory obligation to furnish the buyer and the seller proper closing statements accounting for the transaction. Most of the major money amounts and their distribution are a direct result of what the buyer and seller have agreed to in the Contract to Buy and Sell Real Estate. Other items may depend upon state or federal law, tradition, requirements of a specific loan program, the lender, or who will benefit from the expense charged.

The **six-column closing worksheet** that follows is provided for the broker's convenience. Use of the form is not mandatory. It is used by the closer or broker to keep track of all the items that need to be debited and credited between the parties to create the closing documents. Once all the expenses are accounted for and the closing worksheet balances, the broker will create the individual closing statements for the buyer and seller. If the brokerage uses a title company, all of these figures are in a computer program. In this case there is no actual six-column closing worksheet produced, only the closing statements.

Figure 1.2: Six-Column Worksheet

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price						
2. Deposit, paid to:						
3. Deed of Trust, payable						
4. Deed of Trust, payable						
5. Deed of Trust, payoff to						
6. Interest on Loan Assumed						
a. Extended Title						
b. Mortgagee's Port						
8. Closing Fee						
9. Notary Fee						
10. Title Exam by buyer attorney						
11. Recording: Warranty Deed						
12. Deed of Trust						
13. Release						
14. Other						
15. Documentary Fee						
16. Certificate of Taxes Due						
17. Taxes for Preceding Year(s)						
18. Taxes of Current Year						
19. Tax Reserve						
20. Special Taxes (Assessments)						
21. Personal Property Taxes						
22. Notary Fee paid by Lender						
23. Premium for New Insurance						
24. Hazard Ins. Reserve						
25. FHA Mortgage Ins. Assumed						
26. FHA Mortgage Ins. Reserve						
27. Loan Origination						
28. Loan Discount Points						
29. Interest on New Loan						
30. Survey and/or Credit Report						
31. Appraisal Fee						
32. Water and/or Sewer						
33. Rents						
34. Security Deposit						
35. Loan Transfer Fee						
36. Loan Payment Due						
37. Broker's Fee						
Sub-Totals						
Balance Due to/from Seller:						
Balance Due to/from Buyer						
TOTALS						

DEBIT: an amount the party owes. Reduces the party's bottom line

CREDIT: an amount the party receives. Improves the party's bottom line

Broker DEBIT: an amount deposited into the broker's escrow account

Broker CREDIT: a check out of the broker's escrow account

Balances due to or from the parties. This is the reason for the entire settlement worksheet!

How to Use the Six-Column Closing Worksheet

Later in this unit, we will discuss how the broker debit and credit columns work. For now, we will focus on just the seller and buyer items.

Item	SELLER		BUYER	
	Debit	Credit	Debit	Credit

Who Has the Debit? Who Owes the Money?

Note:

- The word *always* is used for debits and credits when 99% of the time this is how the debit or credit is handled at closing.
- The word *typically* is used when the majority of the time the party named pays for the item.
- The word **negotiable** is used when the Contract to Buy and Sell has a checkbox that clearly makes the item negotiable.

These generalities—always, typically, and negotiable—are used to help in teaching the concepts. However, the terms of the Contract to Buy and Sell are the final determinant of who is obligated in any closing for a bill and should always be reviewed. **Remember:** All items in the Contract to Buy and Sell can be negotiated.

### The six-column worksheet:

The numbers used here all correspond to the six-column worksheet used in the closing process. In the back of this book are worksheets you can remove to familiarize yourself with these various items.

**Line 1. Selling Price:** This is paid by the buyer, in order to obtain the deed.

- Always debit the buyer.

### Line 5. Seller Loans to Be Paid Off (Deed of Trust, Payoff to)

- Any current loans the seller has, that the buyer will not assume, will need to be paid off at closing.
- Always debit the seller.

		Who Pays?	SELLER		BUYER	
			Debit	Credit	Debit	Credit
1.	Selling Price	BUYER			XXX.XX	
5.	Deed of Trust, payoff to:	SELLER	XXX.XX			

**Line 7. Title Insurance: Owner's Title Insurance Premium:** The approved Contract to Buy and Sell specifies that the seller will pay for the owner's (buyer's) standard title insurance policy.

- Always debit the seller.

**Line 7a. Extended Title Insurance Coverage:** The approved Contract to Buy and Sell determines if the seller or the buyer pays for the extended coverage.

- Negotiable: debit the seller or buyer per the contract.

**Line 7b. Mortgagee's Policy Premium:** The mortgagee's title insurance policy (lender's policy) is part of the cost of borrowing and is paid by the borrower/buyer.

- Always debit the buyer.

**Line 10. Title Examination by Buyer's Attorney:** The buyer's attorney would review the title insurance commitment for possible problems. If the buyer has an attorney, the buyer will pay this bill.

- Always debit the buyer.

		Who Pays?	SELLER		BUYER	
			Debit	Credit	Debit	Credit
7.	Owner's Title Insurance Premium	SELLER	XXX.XX			
	a. Extended Title Coverage	SELLER/ BUYER	XXX.XX		XXX.XX	
	b. Mortgagee's Title Insurance	BUYER			XXX.XX	
10.	Title Exam by: Buyer's Attorney	BUYER			XXX.XX	

**Recording Fees:** In Colorado, a buyer normally pays recording charges, except for the recording of any release (payoff) of prior liens.

**Line 11. Recording the Warranty Deed:** This benefits the buyer by providing constructive notice of the buyer's interest and ownership of the property.

- Always debit the buyer.

**Line 12. Recording the Deed of Trust:** The buyer/borrower pays for this loan cost. The deed of trust is the document that protects the lender and creates the lien on the property.

- Always debit the buyer.

**Line 13. Recording a Release of Deed of Trust:** If a prior loan is being paid off as part of the closing, the seller has the obligation to convey the property cleared of this lien. The release must be recorded, so it is the seller's obligation. There will also be a corresponding debit under loan payoff for the amount of any liens being paid off by the seller.

- Always debit the seller.

		Who Pays?	SELLER		BUYER	
			Debit	Credit	Debit	Credit
11.	Recording: Warranty Deed	BUYER			XXX.XX	
12.	Recording: Trust Deed	BUYER			XXX.XX	
13.	Recording: Release	SELLER	XXX.XX			

**Line 15. Documentary Fee:** This is a fee required by state law and paid to the county with the recording of any conveyance deed (a deed conveying property from a grantor to a grantee).

- The amount is \$0.01(one cent) per \$100 of purchase price. There are two ways to calculate this:
  - divide the selling price by \$10,000, or
  - move the decimal point in the selling price four places to the left.
  - For example, the fee for a purchase price of \$230,000.00 will be \$23.00.
- Every closing has a documentary fee because there will be a conveyance deed that needs to be recorded. State law requires the party that records a document of conveyance to pay the documentary fee.

Always debit the buyer (who benefits from recording the deed).

**Line 16. Certificate of Taxes Due:** This certificate from the County Treasurer verifies the current status of taxes due on the property and the amount of the previous year's taxes.

- This benefits the buyer by ensuring that all unpaid taxes will be paid off at closing and there are no other taxes due at closing.
- Always debit the buyer.

**Line 17. Unpaid Taxes for Preceding Year(s):** If any unpaid taxes for years preceding the year of closing are due, they are entirely the seller's responsibility, as they have created a lien on the property that must be cleared.

**Line 18. Unpaid Taxes for Current Year:** These are prorated at closing.

- Always debit the seller.
  - If taxes for preceding years have been paid, this line will be blank.

**Tip:** If the prior year's taxes have been paid, note the amount in the left margin. This amount will be used in calculating the tax proration for the year of closing.

**Remember:** In real-life closings, taxes could be prorated using the most current mill levy and assessment. How taxes are prorated is determined by the Contract to Buy and Sell.

		Who Pays?	SELLER		BUYER	
			Debit	Credit	Debit	Credit
15.	Documentary Fee	BUYER			XXX.XX	
16.	Certificate of Taxes Due	BUYER			XXX.XX	
17.	Taxes for the Preceding Year(s)	SELLER	XXX.XX			

**Line 20. Special Taxes/ Assessments:** These are amounts due on government special assessments or tax for local improvements. These assessments are onetime charges that are typically paid to the government over several years, in addition to the general property taxes.

- If a special tax or assessment is to be paid off at closing, it is the seller's responsibility to pay off the full amount that is owed.

Always debit the seller for the full amount of the special assessment.

- If the special tax is assumed by the buyer (not paid off), it will not impact the money at closing and will not appear on the settlement sheet. The buyer has agreed to take over the payments. Therefore, since nothing is being paid off, it will not show on the closing worksheet.

**Special rule:** If the seller pays, debit the seller. If the buyer assumes the payment, it does not show at closing.

**Line 37. Broker's Fee:** The broker's fee is a seller cost based on the listing contract.

- Always debit the seller.

		Who Pays?	SELLER		BUYER	
			Debit	Credit	Debit	Credit
20.	Special Taxes (if paid off)	SELLER	XXX.XX			
37.	Broker's Fee	SELLER	XXX.XX			

## Loan Costs

**Line 27. Loan Origination Fee (or Loan Service Fee):** This is a fee charged by the lender for services related to creating a new loan. Normally, it is a debit to the buyer because it is a requirement of getting the loan. Think of it as the commission the lender is receiving for originating the loan.

- Typically, debit the buyer.

**Line 28. Loan Discount Points:** The sales contract states that the buyer will pay this cost. It is a debit to the buyer because it is a requirement of getting the loan at a certain interest rate.

- The discount points are a percentage of the loan amount, not the sales price.
- One point equals 1% of the loan amount.
- Debit the buyer unless the contract states differently.

**Line 30. Survey:** The sales contract states who will pay for the survey.

- Negotiable: debit the seller or the buyer per the contract.



**Line 30. Credit Report:** If the seller or the lender wishes to determine the credit worthiness of the buyer, a credit report may be ordered. This is charged to the buyer as a cost of getting a loan.

- Always debit the buyer.

**Line 31. Appraisal Fee:** The sales contract states who will pay for the appraisal, but normally it is a debit to the buyer because it is a cost for getting a loan.

- Negotiable: debit the seller or the buyer per the contract.

**Line 35. Loan Transfer Fee:** In an assumption, the lending institution usually requires a fee for changing the loan records (i.e., transferring the loan from the seller's information to the buyer's).

- Typically, debit the buyer.

**Line 36. Loan Payment Due:** All payments on the loan must be up to date before the loan can be assumed. The payment reduces the amount of principal owed by the seller on the loan. Since loan payments are made in arrears, the seller will owe the full amount of the payment due for the preceding month.

- Never prorate the monthly payment that is past due.
- Always debit the seller.

**Lines 19 & 24. Lender Reserve Impound Accounts:** For most loans, the lender will require the buyer to give the lender funds to establish reserve accounts to pay the taxes and property insurance when the bills come due. Remember, property taxes have priority over all other liens if not paid. Property insurance would be used to pay off the debt if the property is damaged. The lender will require the buyer to collect for and pay these bills for most loans. The lender will always collect for the month of closing.

Buyer/borrower funds may be held for the following:

- Annual property taxes are typically paid on April 30.
- An annual hazard insurance premium is paid based on the policy date; it is typically due one year from the closing date.
- Always debit the buyer.

**Line 23. Premium for New Insurance:** The buyer will provide insurance.

- Always debit the buyer.

		Who Pays?	SELLER		BUYER	
			Debit	Credit	Debit	Credit
19.	Tax Reserve	BUYER			XXX.XX	
23.	Premium for New Insurance	BUYER			XXX.XX	
24.	Hazard Insurance Reserve	BUYER			XXX.XX	

**Line 8. Closing Fee:** Typically, there will be a closing fee to be split between the buyer and the seller, but in some cases one party—either the buyer or the seller—will pay the entire fee. In either case, the sales contract and the closing instructions will provide the needed information.

- Negotiable: debit the seller or the buyer per the contract.

**Line 9. Notary Fees:**

**Special rule:** A notary fee is paid by the party who signs the document.

The party actually signing the document would owe the bill for the notary fee, which will then be a credit to the broker, who writes the check and pays the bill for the responsible party.

- Debit the party signing the document.
- The seller/grantor signs the warranty deed and will always be charged for a notary fee.
- The buyer/borrower signs the deed of trust and will always be charged if there is a new loan.
- The broker will be credited the combined amounts to pay the bill.
  - Example: The notary fee is \$1.00 per document and each party needs to have the signature notarized. The seller and buyer will each be debited \$1.00, with the broker receiving a credit of \$2.00 to pay the notary bill in full.

		SELLER		BUYER		BROKER	
		Debit	Credit	Debit	Credit	Debit	Credit
8.	Closing Fee	X		X			XX
9.	Notary Fee	X		X			XX

### Summary of Debits: Who Pays Which Bills?

	Bill to Be Paid	Who Pays?	SELLER		BUYER	
			Debit	Credit	Debit	Credit
1.	Selling Price	BUYER			XXX.XX	
7b.	Mortgagee's Title Insurance	BUYER			XXX.XX	
10.	Title Exam by: Buyer's Attorney	BUYER			XXX.XX	
11.	Recording: Warranty Deed	BUYER			XXX.XX	
12.	Recording: Trust Deed	BUYER			XXX.XX	
15.	Documentary Fee	BUYER			XXX.XX	
16.	Certificate of Taxes Due	BUYER			XXX.XX	
19.	Tax Reserve	BUYER			XXX.XX	
24.	Hazard Insurance Reserve	BUYER			XXX.XX	
25.	Loan Transfer Fee	BUYER			XXX.XX	
23.	Premium for New Insurance	BUYER			XXX.XX	
27.	Loan Origination Fee	BUYER			XXX.XX	
30.	Credit Report	BUYER			XXX.XX	
28.	Loan Discount Points	BUYER			XXX.XX	
8.	Closing Fee*	BUYER/SELLER	XXX.XX		XXX.XX	
9.	Notary Fee	BUYER/SELLER	XXX.XX		XXX.XX	
30.	Survey*	BUYER/SELLER	XXX.XX		XXX.XX	
31.	Appraisal Fee*	BUYER/SELLER	XXX.XX		XXX.XX	
7a.	Extended Title Ins. Coverage*	BUYER/SELLER	XXX.XX		XXX.XX	
7.	Owner's Title Insurance Premium	SELLER	XXX.XX			
13.	Recording Release of Lien	SELLER	XXX.XX			
17.	Taxes for the Preceding Year(s)	SELLER	XXX.XX			
5.	Seller Loan to Be Paid Off	SELLER	XXX.XX			
20.	Special Taxes/Assessments	SELLER	XXX.XX			
36.	Loan Payment Due	SELLER	XXX.XX			
37.	Broker's Fee	SELLER	XXX.XX			
38.	Seller's Attorney	SELLER	XXX.XX			

**Reminder:** Payment for any appraisal, survey, and closing service costs is negotiable in the contract, so either party may have these items as a debit! (**Remember:** ASC what was negotiated.)

The majority of these items are debits for bills to be paid. These items will become credits to the broker, who will write a check to pay the various bills owed by each party.

## Who Receives What? Who Gets the Credit (Money Received)?

**Selling Price:** This is paid to the seller by the buyer; therefore, credit the seller.

- Always credit the seller.

**Earnest Money Deposit:** Earnest money is provided by the buyer before closing and held in an escrow account. At the closing, the buyer will receive a credit (reducing the amount of cash the buyer needs to bring to the closing).

- Always credit the buyer.

## Debit vs. Credit for the Cash Closing

Below is a closing worksheet based on a cash closing between a seller and buyer.

**Note:** Only the items that apply to the closing are included in the following table.

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price		X	X			
2. Deposit, paid to				X	X	
7. Title Insurance Premium Owner's	X					X
8. Closing Fee Split 50/50	X		X			XX
9. Notary	X		X			XX
10. Title Exam by: Buyer's Attorney			X			X
11. Recording: Warranty Deed			X			X
12. Recording: Trust Deed			X			X
13. Recording Release of Lien	X					X
15. Documentary Fee			X			X
16. Certificate of Taxes Due			X			X
18. Taxes for Current Year Prorated between the parties	X			X		
23. Premium for New Insurance			X			X
37. Broker's Fee	X					X

Negotiated in the contract

Notice how each debit has a matching credit in another column. These debits and credits are also always equal dollar amounts. For example, if the title insurance costs \$1,000, there is a debit to the seller, who owes the bill, and a credit of \$1,000 to the broker, who will write a check to pay the bill for the seller.

## Steps for Balancing a Seller's Closing Statement

### Subtotals:

- Once all of the entries are on the worksheet, both the seller columns are subtotaled.

### Balance Due To/From Seller:

- Once a subtotal of the seller's debit and credit columns is complete, the broker will analyze the situation. If the seller has more credits than debits (as in the example), the seller will receive some money at the closing.
- Compute the difference between the credits and debits and enter the amount (in this case, \$130,586.49) under the smaller of the two numbers on the "balance due to the seller" line, thus forcing a balance for the seller's total debits and total credits.

Since the broker will collect and disburse all money, a balance due to the seller means the broker who is closing the transaction must write a check to the seller for net proceeds, so this amount is also noted in the broker's credit column.

- If the seller has more debits than credits (which sometimes happens), this is known as a **deficit closing**. Again, compute the difference between the debits and credits and enter that amount on the smaller side, forcing a balance. This difference is the amount the seller will need to bring to closing in good funds, which the broker will deposit into the escrow account to pay the bills owed.

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
Subtotals	11,430.55	142,017.04				
Balance Due TO/From Seller	130,586.49					130,586.49
Balance Due To/From Buyer						
Totals	142,017.04	142,017.04				

Since the balance is due TO the seller, the amount due goes to the left side to balance the two columns.

The same number is also put into the broker CREDIT column, as this is the check the broker will write to the seller at closing.

### Totals:

Once the balance due to/from the seller is completed, add the subtotal figure to any balance due to/from figure in that column to obtain the totals, which must be the same or the seller side does not balance.

**Important:** The seller's totals of debits and credits must be the same. If not, the closing statement is incorrect and does not balance.

## Steps for Balancing the Buyer's Closing Statement

### Subtotals:

- Once all the entries are made on the closing statement, subtotal both columns.

### Balance Due To/From Buyer:

- Once a subtotal of the buyer's debit and credit columns is complete, the broker must again analyze the situation.
- If the buyer has more debits than credits (as in the example), the buyer will be bringing money to closing.
- Compute the difference between the credits and debits and enter the amount (in this case, \$140,596.69) under the smaller of the two numbers on the "balance due from the buyer" line, thus forcing a balance for the buyer's total debits and total credits. These must balance or there is an error.

Since the broker will collect and disburse all money, a balance due *from* the buyer means the broker must receive and deposit that amount in good funds from the buyer at closing. The amount the buyer must bring is also noted in the broker's debit column.

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
Subtotals			142,767.24	2,170.55		
Balance Due TO/From Seller						
Balance Due To/FROM Buyer				140,596.69	140,596.69	
Totals			142,767.24	142,767.24		

Since the balance is due FROM the buyer, the amount due goes on the right side to balance the two columns.

The same number is also put into the broker debit column. This is the check the broker will deposit from the buyer to cover what is due to the seller.

### Totals:

- Once the balance due to/from the buyer is complete, add the subtotal figure to any balance due to/from figure in that column to obtain the totals.

**Important:** The buyer's totals of debits and credits must be the same. If not, the closing statement is incorrect and does not balance.

### Remember:

A closing statement that balances is not necessarily correct!

If you leave out an entire item or reverse a debit and credit entry on a line, the sheet may balance but be inaccurate. Do every settlement closing worksheet as though your career as a real estate licensee depends on it—it may.

Closing statements must be signed per Commission rules.

## Broker Totals: How to Find the Subtotal and Total for Each Column

Remember:

A settlement statement that balances is not necessarily correct!

If you leave out an entire item or reverse a debit and credit entry line, the sheet may balance but be inaccurate. Do every settlement closing worksheet as though your career as a real estate licensee depended on it—it may.

### V. Broker Totals: How to Find the Subtotal and Total for Each Column

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
Subtotals	11,430.55	142,017.04	142,767.24	2,170.55	1,800	11,810.20
Balance Due TO/From Seller	130,586.49					130,586.49
Balance Due To/From Buyer				140,596.69	140,596.69	
Totals	142,017.04	142,017.04	142,767.24	142,767.24	142,396.69	142,396.69

Balance Due TO Seller: Subtract the debit from the credit subtotal. (Enter the balance TO on the left.) Once determined, put it in the broker credit column, as this is the amount the broker will have to write as a check to the seller for the net proceeds.

Balance Due FROM Buyer: Subtract the credit from the debit subtotal. (Enter the balance FROM on the right.) Once determined, put it in the broker debit column, as this is the amount the broker will have to collect (deposit) from the buyer.

If the broker columns do not balance, check the seller and buyer columns.

### **Seller and Broker Totals:**

- Once the seller's "balance due total" amount is found (seller debit), this amount is also moved under the broker's credit subtotal. **Remember:** This is the check the broker will write to the seller for the net proceeds.

### **Buyer and Broker Totals:**

- Once the buyer's "balance due from" amount is found, this amount is also moved under the broker's debit subtotal. **Remember:** This is the check the buyer will bring and the broker will deposit to pay the bills and the seller net proceeds. Now the broker columns are totaled and balanced.

Review the six-column worksheet that follows. Notice how the debits and credits are charged. Examine how the lines are then totaled and balanced.

	SELLER				BUYER				BROKER			
	Debit		Credit		Debit		Credit		Debit		Credit	
1. Selling Price			142,000	00	142,000	00						
2. Deposit, Paid to:							1,800	00	1,800	00		
3. Deed of Trust, Payable to:												
4. Deed of Trust, Payable to:												
5. Deed of Trust, Payoff to:												
6. Interest on Loan Assumed												
7. Owner's Title Insurance Premium	764	00									764	00
a. Extended Title Insurance												
b. Mortgagee's Policy												
8. Closing Fee	75	00			75	00					150	00
9. Notary Fee	1	00									1	00
10. Title Exam by Buyer's Attorney					160	00					160	00
11. Recording: Warranty Deed					6	00					6	00
12. Deed of Trust												
13. Release												
14. Other												
15. Documentary Fee					14	20					14	20
16. Certificate of Taxes Due					15	00					15	00
17. Taxes for Preceding Year(s)												
18. Taxes for Current Year	370	55					370	55				
19. Tax Reserve												
20. Special Taxes/Assessments	1,700	00									1,700	00
21. Personal Property Taxes												
22. Notary Fee Paid by Lender												
23. Premium for New Insurance					480	00					480	00
24. Hazard Ins. Reserve												
25. FHA Mortgage Ins. Assumed												
26. FHA Mortgage Ins. Reserve												
27. Loan Origination												
28. Loan Discount Points												
29. Interest on New Loan												
30. Survey												
Credit Report												
31. Appraisal Fee												
32. Water and/or Sewer			17	04	17	04						
33. Rents												
34. Security Deposits												
35. Loan Transfer Fee												
36. Loan Payment Due												
37. Broker's Fee	8,520	00									8,520	00
38. Seller's Attorney												
39. Net Loan Proceeds												
Subtotals	11,430	55	142,017	04	142,767	24	2,170	55	1,800	00	11,810	20
Balance Due To/From Seller	130,586	49									130,586	49
Balance Due To/From Buyer							140,596	69	140,596	69		
TOTALS	142,017	04	142,017	04	142,767	24	142,797	24	142,396	69	142,396	69

## Creation of Closing Statements

When the six-column worksheet is complete and balanced, the results are used to create the individual closing statements for seller and buyer to sign at closing. **Note:** The broker does not have a closing statement.

Figure 1.3 shows closing statements for the previous worksheet.

**Figure 1.3: Closing Statement**

The printed portions of this form, except differentiated additions, have been approved by the Colorado Real Estate Commission. (SS60-9-08) (Mandatory 1-09)

☐ **ESTIMATE**
☐ **FINAL**

**CLOSING STATEMENT**  
☒ SELLER'S    ☐ PURCHASER'S

PROPERTY ADDRESS: *124 Any Street, Your town, Colorado 80999*  
 SELLER: *Stanley Seller and Myrtle Q. Seller*      BUYER: *Stanley E Bedford and Catherine J. Bedford*

SETTLEMENT DATE: *August 22, 2xxx*      DATE OF PRORATION: *August 22, 20xx*

LEGAL DESCRIPTION: *Lot 2, Filing 6, Horse property Subdivision, Weld County, Colorado*

	Debit	Credit
1. Selling Price		142,00.00
2. Deposit paid to		
3. Trust Deed payable to		
4. Trust Deed payable to		
5. Trust Deed, payoff to <i>previous lender</i>		
6. Interest on Loan Assumed <i>new second</i>		
7. Title Insurance Premium	764.00	
8. Closing Fee	75.00	
9. Notary Fees	1.00	
10. Title Exam by		
11. Recording: Warranty Deed		
12. Trust Deed		
13. Release		
14. Other		
15. Documentary Fee		
16. Certificate of Taxes Due		
17. Taxes for Preceding Years(s)		
18. Taxes for Current Year	370.55	
19. Tax Reserve		
20. Special Taxes	1,700.00	
21. Personal Property Taxes		
22. Notary Fee paid by Lender		
23. Premium for New Insurance		
24. Hazard Ins. Reserve		
25. FHA Mortgage Insurance Assumed		
26. FHA Mortgage Ins Reserve		
27. Loan Service Fee (Buyer)		
28. Loan Discount Fee		
29. Interest on New Loan		
30. Survey and/or Credit Report		
31. Appraisal Fee		
32. Water and/or Sewer Report		17.04
33. Rents		
34. Security Deposits		
35. Loan Transfer Fee		
36. Loan Payment Due		
37. Broker's Fee	8520.00	
<i>Seller's Attorney</i>		
Net Proceeds from a new loan		
Sub-Totals	11,430.55	142,017.04
Balance Due to/from Seller	130,586.49	
Balance Due to/from Buyer		
<b>TOTAL</b>	<b>142,017.04</b>	<b>142,017.04</b>

**APPROVED AND ACCEPTED**

Buyer/Seller: \_\_\_\_\_

Buyer/Seller: \_\_\_\_\_

Brokerage Firm's Name: \_\_\_\_\_

Broker: \_\_\_\_\_



**FIGURE 1.3: Closing Statement (continued)**

The printed portions of this form, except differentiated additions, have been approved by the Colorado Real Estate Commission. (SS60-9-08) (Mandatory 1-09)

☐ **ESTIMATE**
☐ **FINAL**

**CLOSING STATEMENT**  
SELLER'S ☐ BUYER'S ☒

PROPERTY ADDRESS: *124 Any Street, Your town, Colorado 80999*  
 SELLER: *Stanley Seller and Myrtle Q. Seller* BUYER: *Stanley E Bedford and Catherine J. Bedford*

SETTLEMENT DATE: *August 22, 2xxx* DATE OF PRORATION: *August 22, 2xxx*

LEGAL DESCRIPTION: *Lot 2, Filing 6, Horse property Subdivision, Weld County, Colorado*

	Debit	Credit
1. Selling Price	142,000.00	
2. Deposit paid to listing broker		1,800.00
3. Trust Deed payable to		
4. Trust Deed payable to		
5. Trust Deed, payoff to		
6. Interest on Loan Assumed		
7. Title Insurance Premium		
8. Closing Fee	75.00	
9. Notary Fees		
10. Title Exam by <i>James Snow</i>	160.00	
11. Recording: Warranty Deed	6.00	
12. Trust Deed		
13. Release		
14. Other		
15. Documentary Fee	14.20	
16. Certificate of Taxes Due	15.00	
17. Taxes for Preceding Years(s)		
18. Taxes for Current Year		370.55
19. Tax Reserve		
20. Special Taxes		
21. Personal Property Taxes		
22. Notary Fee paid by Lender		
23. Premium for New Insurance	480.00	
24. Hazard Ins. Reserve		
25. PMI		
26. Mortgage Ins Reserve		
27. Loan Origination Fee		
28. Loan Discount Points		
29. Interest on New Loan		
30. Survey and/or Credit Report		
31. Appraisal Fee		
32. Water and/or Sewer	17.04	
33. Rents		
34. Security Deposits		
35. Closing Service		
36. Loan Payment Due		
37. Broker's Fee		
<i>Sellers Attorney</i>		
Net proceeds new loan		
Sub-Totals	142,767.24	2,170.55
Balance to/from Seller		
Balance to/from Buyer		140,596.69
<b>TOTAL</b>	<b>142,767.24</b>	<b>142,767.24</b>

**APPROVED AND ACCEPTED**

Buyer/Seller: \_\_\_\_\_

Buyer/Seller: \_\_\_\_\_

Brokerage Firm's Name: \_\_\_\_\_

Broker: \_\_\_\_\_

**Prorations: Dividing Expenses Between the Buyer and Seller**

Most existing properties have various ongoing expenses that must be divided between the seller and the buyer. These could include interest on a loan the buyer is assuming, general property taxes, water and sewer bills, rents collected in advance on a leased property, and homeowners association dues. We will investigate each of these items individually.

Prorations will not normally include utilities such as electricity, telephone, or cable TV service since these are billed to the individual and can be stopped as of the date of closing and a new account opened for the buyer. These companies do not have the right by law to place liens on the property, if the bill is left unpaid, without going to court. Water, sewer, and property tax bills can (by law) become a lien against the property, so the broker must ensure these are taken care of at closing.

## Closings Prorations Helper

### Proration Rules and Method

1. Whether the seller or the buyer should be charged for the day of closing varies from state to state.
  - The Colorado Contract to Buy and Sell Real Estate specifies that proration items “shall be apportioned *to* the day of closing” (not *through*).
  - Therefore, the buyer owns the property all day on the day of closing.
2. When prorating in Colorado, a year has 365 days.
  - A leap year with February having 29 days has 366 days.
  - The calendar year begins on January 1 and goes through December 31.
3. Every month must be calculated according to the exact number of days in that particular month. Do you remember the following rhyme?

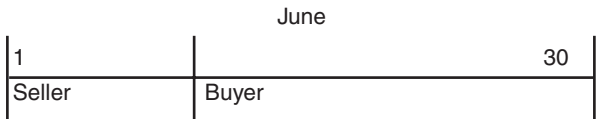
30 days have September, April, June, and November.  
All the rest have 31, and February’s great with 28.  
Leap Year’s February’s fine with 29.
4. **Remember:** Never prorate the following:
  - Tax reserve
  - Hazard insurance reserve
  - Loan payment due
  - Security deposits
  - Mortgage payment due for the month prior to closing
  - Special taxes/ assessments (The Colorado Sales Contract states that the seller pays the special assessments. If the buyer and seller modify the contract and have the buyer assume the special assessment, then it will not be part of the closing figures.)

How To Prorate

	National Test	State Test
Who owns the day of closing	SELLER	BUYER
Days in the month	30 in every month	ACTUAL
Days in the year	360	365/366 (leap)

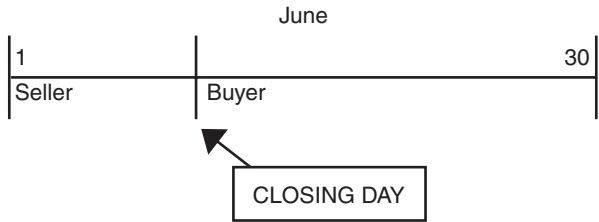
Step 1:

Draw a horizontal line representing the entire billing period for the item being prorated. Add short vertical lines at each end to show the limits, with the beginning date just inside the left-hand vertical line and the last date just inside the right-hand line.



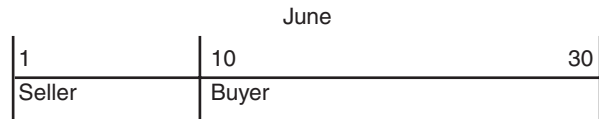
Step 2:

Draw another vertical line near the closing date (use rough proportions). Presume a closing date of June 10.

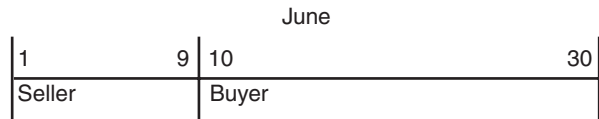


Step 3:

Put the closing date on the right side of the vertical line (buyer's first day of ownership).



Put the day before closing on the left side of the vertical line (seller's last day of ownership).

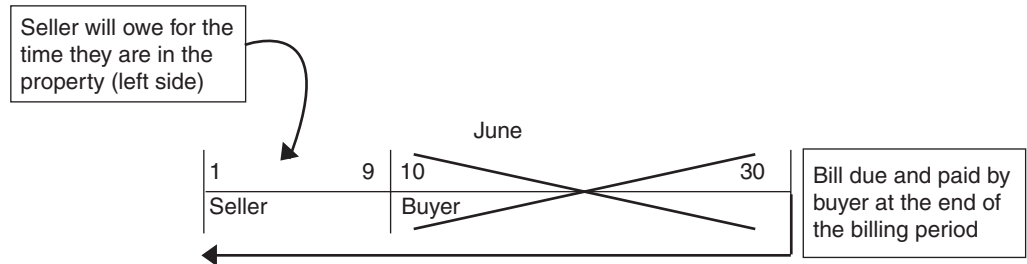


Step 4:

Determine if the item to be prorated is paid in arrears. The buyer will receive a bill later for a charge that will include time the seller was in the property (property taxes are an example). An item may be paid in advance; in this case, the seller has already paid a bill and the buyer will take over the property during that period. Water is often paid in advance. In either case, one party will owe the other for the period in which the party is in the property but has not paid.

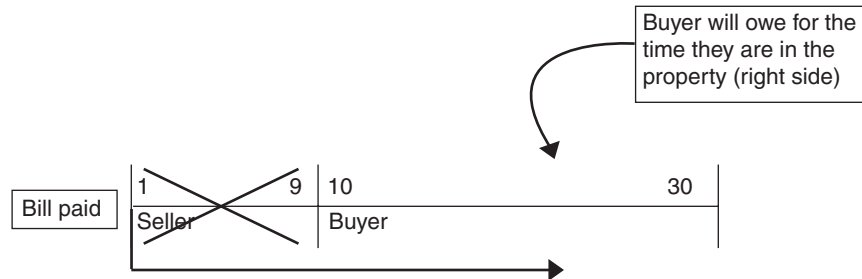
**SOB side (seller owes buyer):** solve the left side of the timeline

- This side is paid in arrears: the buyer will pay the bill in the future.
- Includes items such as real estate taxes and interest on most real estate loans.



**BOS side (buyer owes seller):** solve the right side of the timeline

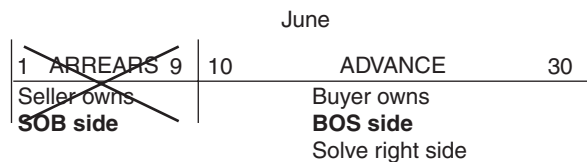
- This side is paid in advance (“prepaid,” “paid,” “was paid,” “has already paid”).
- Water and HOA fees are often paid in advance.



Begin	Closing	End
BILL PAID IN <b>ARREARS</b>	BILL PAID IN <b>ADVANCE</b>	
Seller owns	Buyer owns	
<b>SOB side</b>	<b>BOS side</b>	
Solve left side	Solve right side	

### Step 5:

Cross off the side of the figure not being used. Now go to the appropriate side and count the days. Use actual number of days in each month.



Determine the days that are owed for the side being worked. In this case, the buyer will be in the property 21 days

To find the buyer’s ownership:  $30 - 9$  (seller’s last day) = 21.

Do *not* make the common error of  $30 - 10$  (buyer’s first day) = 20.

For this item paid in advance, the buyer would owe the seller 21 days.

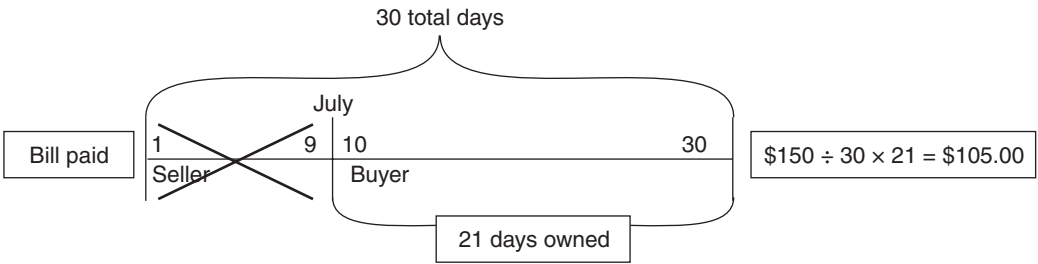
**Step 6:**

Calculate the share for the side owed. In this case, water is paid in advance, so the buyer owes the seller for 21 days.

The formula we use to calculate is always the same:

$$\text{amount for the billing period (\$)} \div \text{days in the billing period} \times \text{number of days the person owes}$$

For a \$150.00 water bill paid in advance, how much does the buyer owe the seller?



**Tip 1:** Start by dividing the bill's dollar amount for the total billing period by the number of days in the total billing period, and then multiply by the number of days the person owns. In our example, the total water amount is \$150, the total billing period is 30 days, and the buyer owns 21 days. The amount owed is calculated as follows:

$$\$150 \div 30 \times 21 = \$105$$

**Tip 2:** A proration is always an exchange between the buyer and the seller. The debit and credit amounts will always be the same. We would debit the buyer, who owes the bill, \$105 and credit the seller, who previously paid the bill, \$105.

**Tip 3:** The seller's last day will always be used to determine the number of days owed. For the buyer's side, take the total number of days minus the seller's last day to determine the number of days the buyer will own the property.

**Tip 4:** Use your calculator for the math rather than writing down the daily amount to enter on the calculator later. Most calculators easily retain the six decimal places needed to ensure an accurate calculation.

$$\text{total bill} \div \text{total days} \times \text{days owned} = \text{prorated \$}$$

**Tip 5:** On the top of the six-column worksheet, write the closing day and the number of days each party has. Remember, this will be different for each closing.



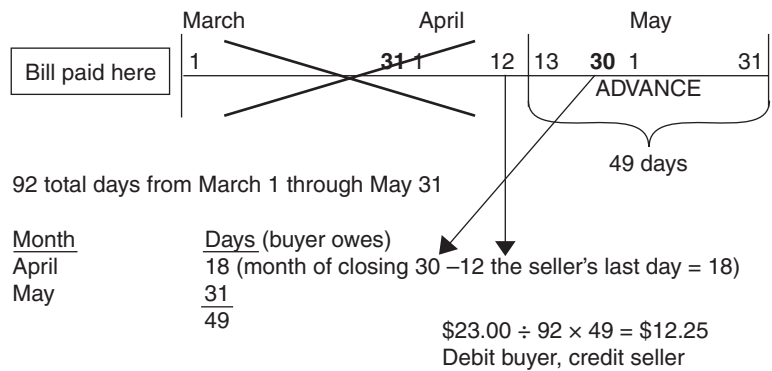
**FOR EXAMPLE**

June 10, seller = 9 days, buyer = 21 days



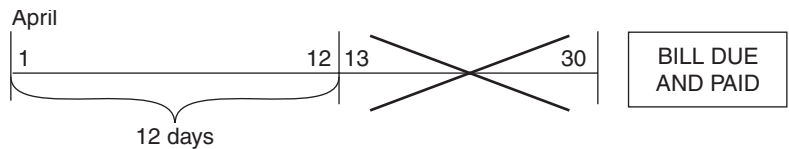
**FOR EXAMPLE**

The unmetered water and sewer bill from March 1 through May 31 has been paid in the amount of \$23 paid in advance (BOS—right side of our drawing). Prorate for a closing on April 13.



**FOR EXAMPLE**

Homeowners association (HOA) fees for the month of April are \$247 paid in arrears (SOB—solve the left side). Prorate the HOA fees for a closing on April 13.



$\$247 \div 30 \times 12 = \$98.80$

Debit the seller, who owes the bill for the time they owned the property, and credit the buyer, who will pay the bill when it becomes due.

## Debits and Credits on a Closing Worksheet

Shown below is how the preceding three prorations would appear on a closing worksheet.

	Who Pays?	SELLER		BUYER	
		Debit	Credit	Debit	Credit
Water paid in advance	BOS		\$105.00	105.00	
Water/sewer paid in advance	BOS		\$12.25	\$12.25	
HOA dues paid in arrears	SOB	\$98.80			\$98.80

### Proration Help Chart

SELLER	BUYER
←	→
<b>Arrears</b>	<b>Advance</b>
Seller owes buyer: SOB	Buyer owes seller: BOS
Debit seller, credit buyer	Debit buyer, credit seller
DS/CB	DB/CS
Interest on assumed loan	Interest on a seller-carry loan
	Often water or HOA dues
Current year taxes	
Any bill paid in arrears (paid after the closing by the buyer)	Any bill paid in advance (paid before the closing by the seller)
Solve left side	Solve right side
Seller always owes buyer rent	

### Exercise 1: Debits and Credits

Fill in the Xs on this worksheet for the proper debit and credit for each party.

		SELLER		BUYER		BROKER	
		Debit	Credit	Debit	Credit	Debit	Credit
1	Selling Price		X	X			
2	Deposit, Paid to						
7	Title Insurance Premium— Owner's						
8	Closing Fee Split 50/50						
9	Notary						
10	Title Exam by: Buyer's Attorney						
11	Recording: Warranty Deed						
12	Recording: Trust Deed						
13	Recording Release of Lien						
15	Documentary Fee						
16	Certificate of Taxes Due						
18	Taxes for Current Year: prorated between the parties						
23	Premium for New Insurance						
37	Broker's Fee						

Using the six-column worksheet helper on the next page, review how the various lines work on the six-column worksheet.

## Real Estate Settlement Closing Worksheet Helper

	All Closings	Assumable		New Loan	
		BUYER		BROKER	
		Debit	Credit	Debit	Credit
Check Out					
1. Selling Price: always use—what the closing is all about (Line 15)					
2. Deposit, Paid to: money the buyer gave the broker			XX		
3. Deed of Trust, Payable to: lender in assumable (Line 6)	XX			XX	
3. Deed of Trust, Payable to: gross loan amount—single entry			S		
4. Deed of Trust, Payable to: seller-carry loan	XX				
5. Deed of Trust, Payoff to: new loan, single entry	S				
6. Interest on Loan Assumed: seller will owe portion of the month of closing	Prorate XX			Prorate XX	
7. Owner's Title Insurance Premium: seller agrees to pay per contract	XX				XX
a. Extended Title Insurance: negotiable charge per the contract	???		???		XX
b. Mortgagee's Policy: buyer cost in new loan, single entry			S		
8. Closing Fee: split between the parties—negotiable charge per contract	??		??		XX
9. Notary Fee: charge person who signs the document	Warranty		Deed of trust		XX
10. Title Exam by Buyer's Attorney: buyer owes; broker will pay the bill			XX		XX
11. Recording: warranty deed: always buyer's—new loan, single entry			Sor XX		XX
12. Deed of Trust: always a buyer fee if one is used			Sor XX		XX
13. Release: seller fee to clear title—new loan, single entry	S				
15. Documentary Fee: move decimal four places to the left in sales price			XX		XX
16. Certificate of Taxes Due: buyer debit—to find what the seller might owe			XX		XX
17. Taxes for Preceding Year(s): note if the seller has paid and the amount	If owed				Only if not paid
18. Taxes for Current Year: seller will owe buyer prorated share	Prorate XX		Prorate XX		
19. Tax Reserve: lender impound—buyer charge, single entry			S		
20. Special Taxes/Assessments: if seller agrees to pay, charge seller	XX				XX
21. Personal Property Taxes: buyer fee if charged			XX		XX
22. Notary Fee Paid by Lender: buyer charge—new loan, single entry			S		
23. Premium for New Insurance: charge buyer for new policy			XX		XX
24. Hazard Ins. Reserve: lender impound; buyer charge—new loan, single entry			S		
27. Loan Origination: charge to buyer—new loan, single entry			S		
28. Loan Discount Points: charge to buyer—new loan, single entry			S		
29. Interest on New Loan: buyer will owe prorated share for the month of closing			Prorate ??		
31. Appraisal Fee: charge buyer—new loan, single entry			S		
32. Water and/or Sewer: prorate month of closing per bill	Prorate ??	Prorate ??	Prorate ??		XX - if not paid
33. Rents: prorate—seller will always owe buyer for buyer's share	Prorate XX		Prorate XX		
34. Security Deposits: transfer full amount from seller to buyer	XX		XX		
35. Loan Transfer Fee: charge buyer fee to transfer in assumable loans			XX		XX
36. Loan Payment Due: seller will owe; credit broker to pay	XX				XX
37. Broker's Fee: seller will owe the brokerage	XX				XX
38. Seller's Attorney: seller owes; broker will pay the bill	XX				XX
39. Net Loan Proceeds: broker deposit, to pay the other new loan bills			S		



## SUMMARY

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Real estate brokers are responsible for making sure that the property is closed properly.

Closing includes preparing or reviewing all of the documents at a closing and checking the allocation of funds represented by the settlement worksheet.

The designated broker representing each party is responsible for accuracy of the figures on the client's closing statement.

Allocating expenses, fees, and other amounts is a complex process requiring skill and care in interpreting the contract as well as following law and local customs.

Prorating ongoing expenses between the seller and buyer is an essential skill in successfully completing a worksheet.

## UNIT 1: GLOSSARY REVIEW

Match the terms with the definitions. Terms may be used more than once.

certificate of taxes due	equal
closing	lender reserve/impound account
closing statement	pay a bill
credit	proration
debit	recording
documentary fee	trust account

1. An amount charged to a party to pay a bill is a \_\_\_\_\_.
2. The place where a broker holds money that belongs to other parties is a \_\_\_\_\_.
3. An amount of \$0.01 per \$100 charged when a deed is recorded is called the \_\_\_\_\_.
4. The document from the county treasurer that summarizes the current status of taxes is the \_\_\_\_\_.
5. An amount received by a party to pay a bill is a \_\_\_\_\_.
6. The final settlement created by the terms of the Contract to Buy and Sell is called \_\_\_\_\_.
7. \_\_\_\_\_ a document creates constructive notice of the contents of the document.
8. A CREDIT to the broker is used to \_\_\_\_\_.
9. Dividing expenses between the buyer and seller based on ownership periods is called \_\_\_\_\_.
10. A place where a lender holds the borrower's funds to pay bills at a later time is a \_\_\_\_\_.
11. A summary of the financial part of a closing for one party to the transaction is a \_\_\_\_\_.
12. DEBITS and CREDITS are always in \_\_\_\_\_ amounts.

## LECTURE OUTLINE

### I. HOW THE CLOSING IS CREATED

- A.** The closing is created by the \_\_\_\_\_ along with other supporting documents, such as the closing instructions, tax certificates, and the title commitment.
- B.** There are \_\_\_\_\_, each with separate obligations that are involved in the closing process:
1. \_\_\_\_\_, who is obligated to \_\_\_\_\_ on the property that are not being assumed by the buyer.
  2. \_\_\_\_\_, who is obligated to meet all the requirements of the contract and \_\_\_\_\_ to closing.
  3. \_\_\_\_\_, who are obligated to verify the party they represent is meeting the obligations of the contract.
    - a. Brokers are also responsible for the \_\_\_\_\_ for the party they have been \_\_\_\_\_.
  4. \_\_\_\_\_ hired by the buyer and seller in the \_\_\_\_\_ is obligated to complete the forms per these instructions.
- C.** The four most typical ways to close a real estate purchase are by using the following:
1. \_\_\_\_\_, which is covered in this unit
  2. \_\_\_\_\_, in which the buyer takes over the seller's existing loan (Unit 2)
  3. \_\_\_\_\_, often used with an assumable loan (Unit 2)
  4. \_\_\_\_\_ (Unit 3)
- D.** Creating the final figures for closing
1. A six-column worksheet is used to determine all the credits and debits for each of the three parties involved.
  2. From the worksheet, the broker/closer will create a separate settlement statement for the seller and buyer.

**E. Responsibility for the proper accounting at a closing:**

1. Overall responsibility belongs to the \_\_\_\_\_.
2. Individual licensee responsibility: The \_\_\_\_\_ are responsible for the accuracy of the settlement statement.
  - a. The designated listing broker is responsible for the settlement statement for the \_\_\_\_\_.
  - b. The designated buyer's broker (selling broker) is responsible for the settlement statement for the \_\_\_\_\_.
3. Brokers are expected to attend the closing. If a designated broker is unable to attend, the employing broker may appoint another broker to attend.
  - a. In this instance, all three brokers, \_\_\_\_\_, will be responsible for the accuracy of the settlement statement for the party represented.

**F. Closing Company or Other Closing Entity**

1. A title insurance closing company, broker, or attorney may perform settlement services on behalf of the seller and buyer.
2. Such a closing entity (company) must be appointed by written closing instructions such as the approved Closing Instructions form.
  - a. Three-party agreement: seller, buyer, and closing company
  - b. Engages \_\_\_\_\_ and outlines requirements for closing
  - c. Lists responsibilities of the closer, buyer, and seller

**II. BUYER'S AND SELLER'S COLUMNS****A. DEBIT, item owed (disadvantage), means one of the following:**

1. A \_\_\_\_\_ to either the buyer or seller on the \_\_\_\_\_, or
2. If the DEBIT is to the seller, it reduces the amount of money the \_\_\_\_\_.
3. If the DEBIT is to the buyer, it increases the amount of money the buyer must bring to closing.

**B. Examples of seller DEBITS (items owed): (Items that reduce the amount of money the seller receives at closing)**

1. Owner's title insurance policy
2. Property taxes for the \_\_\_\_\_; seller will owe the full amount
3. Current year's taxes: seller will owe buyer a prorated share (SOB)
4. Broker's commission (charge to seller)
5. Proration of rents collected for the month of closing; seller will \_\_\_\_\_
6. Security deposits are transferred in full
7. Seller-carry loan

**C. Examples of buyer DEBITS (items owed): (Items that increase the amount of money the buyer must bring to closing)**

1. \_\_\_\_\_ of the property
2. Loan closing costs
3. Mortgagee's title policy
4. Premium for new hazard insurance

**D. Broker DEBIT: deposit INTO the broker's column (escrow account)**

1. Earnest money from the buyer
2. Net loan proceeds from the lender in a new loan

**E. CREDIT: money received (advantage) means the following:**

1. A \_\_\_\_\_ to the buyer or seller (something the buyer/seller receives at closing)
2. A reduction in the amount of money the buyer must \_\_\_\_\_
3. An increase in the amount of money the seller receives at closing

**F. Examples of seller CREDITS: (Items that increase the amount of money the seller receives at closing)**

1. Selling price of the property
2. Proration of bills paid in advance (already paid) by the seller (water and HOA dues)

**G. Examples of buyer CREDITS: (Items that reduce the amount of money the buyer must bring to closing)**

1. \_\_\_\_\_ money already deposited by the buyer and held by the broker or closing company
2. Security deposits transferred from a seller on an investment property
3. Proration of rent for the month of closing—from the seller
4. Proration of property taxes for the current year to be paid in arrears (after the year for which they are collected)
5. The amount of any loans assumed by the buyer or any new loans created as part of the purchase

REMEMBER: Loans are ALWAYS buyer credit.

**H. Broker CREDITS: checks out of the broker's column (escrow account)**

1. All the items the closer/broker pays at closing on behalf of the buyer or seller
2. Title insurance, recording and notary fees, documentary fee, etc.

### III. OVERVIEW OF THE SIX-COLUMN WORKSHEET ENTRIES

### IV. COMPLETING A SIX-COLUMN WORKSHEET

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price		100,000	100,000			
2. Deposit, Paid to:				5,000		
7. Title Insurance Premium—Owner's	625					625
8. Closing Fee Split 50/50						
9. Notary						
10. Title Exam by: Buyer's Attorney			200			200
11. Recording: Warranty Deed			12			12
12. Recording: Trust Deed			20			20
13. Recording: Release of Lien						
15. Documentary Fee						
16. Certificate of Taxes Due			15			15
18. Taxes for Current Year— <b>prorated</b> between parties	420			420		
20. Special Taxes	750					750
23. Premium for New Insurance			600			600
30. Credit Report			50			50
31. Appraisal Fee			350			350
37. Broker's Fee	6,000					6,000
Subtotals	7,871	100,000	101,332	5,420	5,000	8,784
Balance Due TO/From Seller	92,129					92,129
Balance Due To/FROM Buyer				95,912	95,912	
Totals	100,000	100,000	101,332	101,332	100,912	100,912

Negotiated in the contract

Balance Due TO Seller: Subtract the debit from the credit subtotal. Once determined, put in the broker credit column, as this is the amount the broker will have to write as a check to the seller.

Balance Due FROM Buyer: Subtract the credit from the debit subtotal. Once determined, put in the broker debit column, as this is the amount the broker will have to collect (deposit) from the buyer.

If the broker columns do not balance, check the seller and buyer columns.

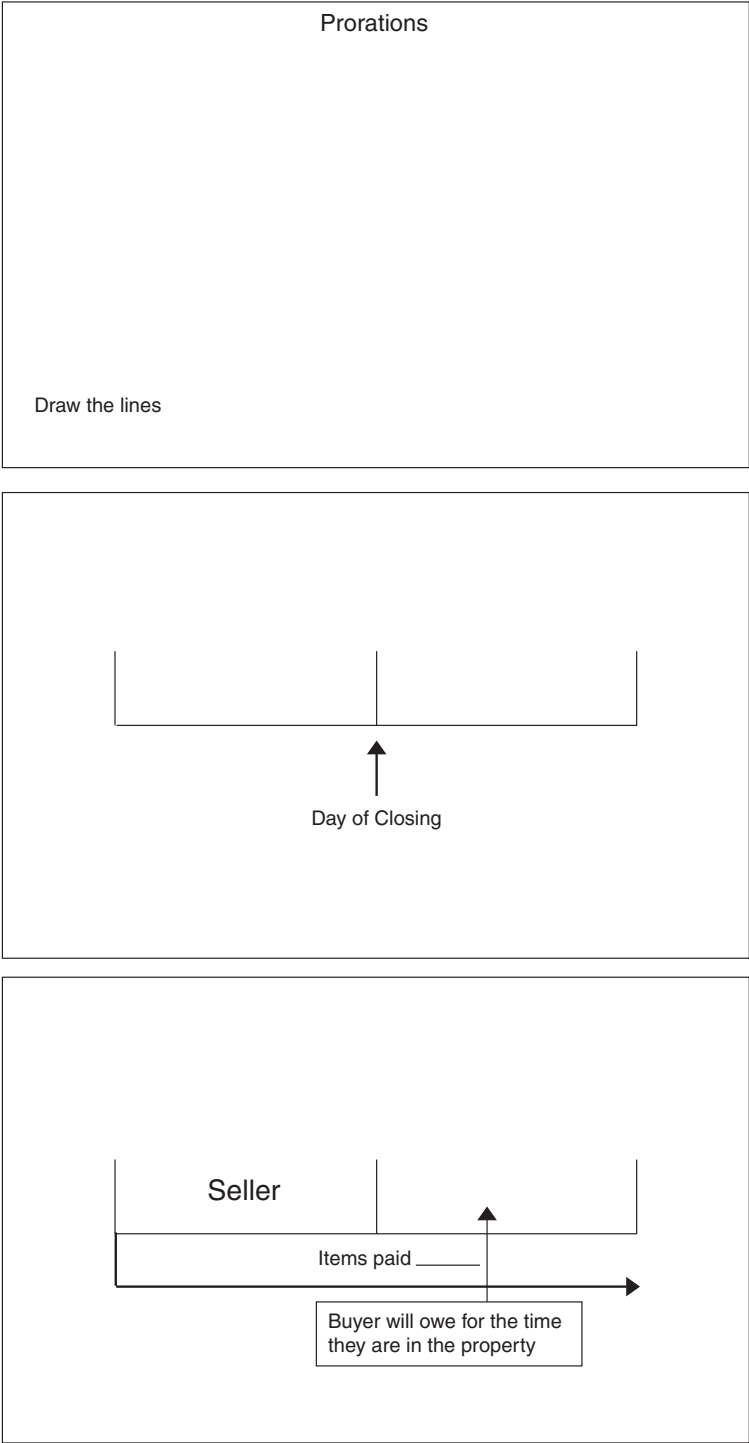
### V. PRORATIONS

#### A. Colorado Rules and Methods

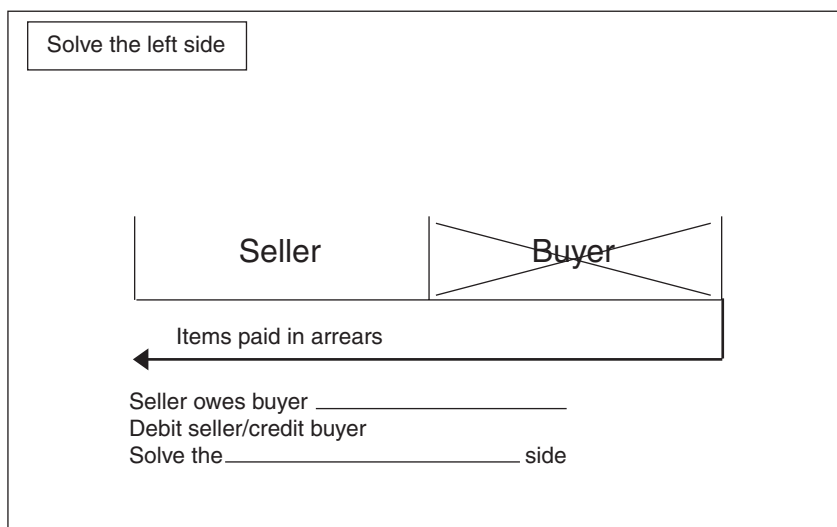
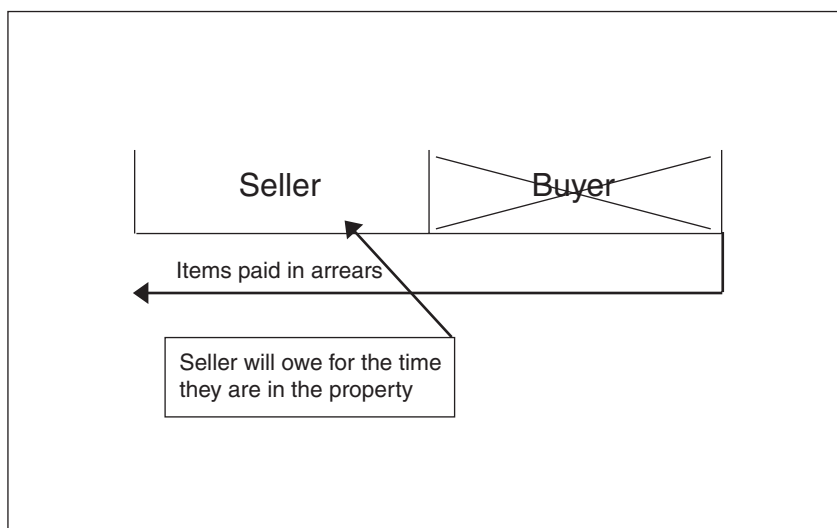
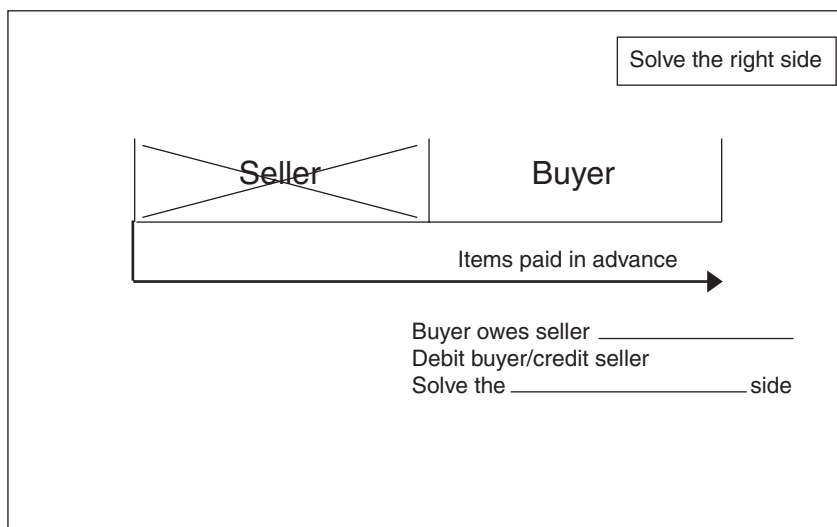
- \_\_\_\_\_ owns on day of closing.
- Use \_\_\_\_\_ days in a year (366 for leap year).
  - Use actual days in calendar months—know how many days:
    - Remember either:
      - 30 days have September, April, June, and November. All the rest have 31, except for February; or
      - Knuckles are 31 days. Spaces in between knuckles are not 31 days.
- \_\_\_\_\_ the following:
  - Security deposits
  - \_\_\_\_\_.  
(Because interest is paid in arrears, a loan payment due pays the month before closing. The seller will owe the full amount.)

- c. Special taxes (special assessments)
- (1) Contract says \_\_\_\_\_ pays off special assessments.
- (2) If both parties agree, could \_\_\_\_\_ and \_\_\_\_\_ on the closing statement.

**B. How to Prorate**







Whenever you prorate, the calculation is always the same:

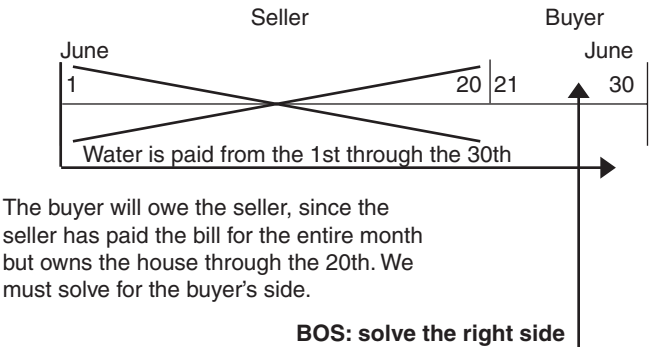
total amount of the bill ÷ days in the billing period × days owned by the party who owes =  
prorated amount

In Colorado, we use a 365-day year and the actual days in the month. For either test, follow the directions given in the exam.

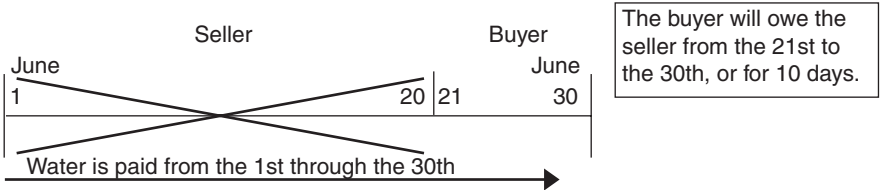
National Test	State Test
Who owns the day of closing?	
How many days in the month?	
How many days in the year?	

**C. Proration Problem**

A property being sold has a water bill of \$60 that has been paid in advance at the beginning of the month. What will be the debit to the buyer at closing on June 21?



The buyer will owe the seller, since the seller has paid the bill for the entire month and owns the house through the June 20. We must solve for the buyer's side.



The formula is always the same:

$$\text{total bill} \div \text{total days} \times \text{days owned}$$

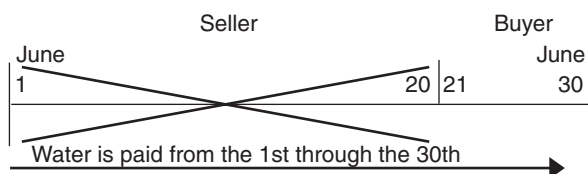
$$\$60 \div 30 (\$2 \text{ per day}) \times 10 = \$20$$

The buyer owes the seller: debit the buyer and credit the seller.

**Big Side vs. Little Side**

Some proration questions can be solved without having to do the math by simply looking for the big side versus little side.

In the problem we just did, the buyer owed the little side.



Let's see how this looks in a problem.

### Big Side vs. Little Side

A property being sold has a water bill of \$60 that has been paid in advance at the beginning of the month. What will be the debit and credit entries for a closing on June 21?

1. Debit buyer \$40, credit seller \$40
2. **Credit seller \$20, debit buyer \$20**
3. Debit seller \$40, credit buyer \$40
4. Credit buyer \$20, debit seller \$20

There is no need to do the math, since you know that the buyer owed (debit the buyer) the seller (credit the seller) the small side of the equations.

### D. Proration Example 1:

Prorate the Colorado general property taxes between the buyer and seller if the tax amount for the preceding year was \$1,366. The closing takes place on April 13. Which party is to be debited? Which will receive a credit for the taxes?

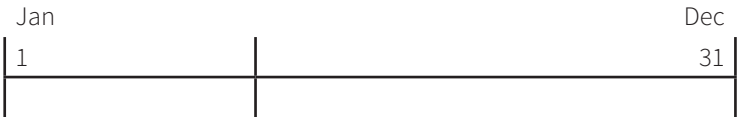
#### Step 1:

Draw a horizontal line representing the entire billing period for the item you are prorating. Add short vertical lines at each end to show the limits with the beginning date just inside the left-hand vertical line and the last date just inside the right-hand line. Annual taxes billed on a calendar-year basis would look like this:



Step 2:

Draw another vertical line near the closing date (use rough proportions). The closing date is April 13.



Step 3:

1. Write the closing date on the right side of the vertical line (buyer’s first day of ownership).



2. Write the day before closing on the left side of the vertical line (seller’s last day of ownership).



Step 4:

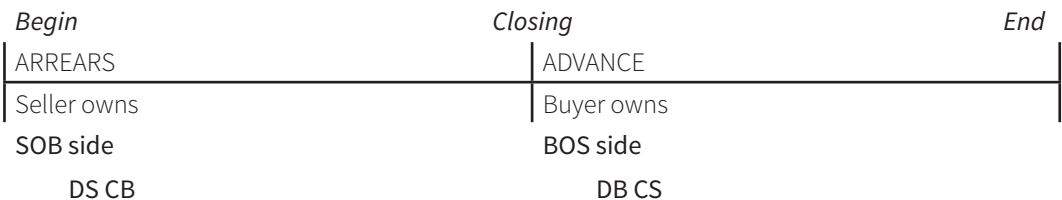
Determine if the item to be prorated is paid in arrears (the buyer will receive a bill after closing that includes charges made during the seller’s ownership period) or paid in advance (the seller has already paid a bill and the buyer owns the property during part of this period). In either case, one party will owe the other for a proportional share of time they owned the property.

SOB (seller owes buyer) side: left side of timeline

- Paid in arrears (i.e., “unpaid,” “not paid,” or “owes”)
- Includes items such as real estate taxes, personal property taxes, and interest on most real estate loans

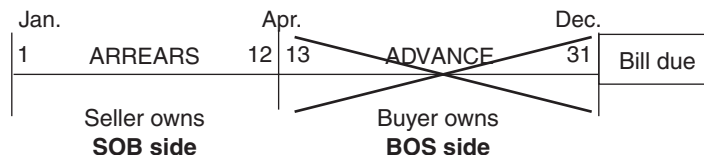
BOS (buyer owes seller) side: right side of timeline

- Paid in advance (i.e., “prepaid,” “paid”)
- Most often water and homeowners association bills



**Step 5:**

Go to the appropriate side (arrears or advance) and draw an X on the side that will *not* be worked—the side that does not owe the bill. Then count the days for the side that owes. Use the actual number of days in each month.



When calculating the days, use the figure on the left of the closing date line (usually) and not the actual date of closing.



In our example, the number of days of seller's ownership in April is 12.

If you need to find the buyer's ownership for something paid in advance, take the number of days in April:  $30 - 12$  (seller's last day) = 18.

Do not make the common error of  $30 - 13$  (buyer's first day) = 17. Remember, always use the seller's last day.

For Colorado real estate taxes for the current year, always count the days on the SOB side:

**Example:**

January	31
February	28
March	31
April	12 (The buyer owns the property the day of closing.)
<hr/>	
	= 102

**Note:** Put the number for the month of closing first, then other months, since the rest will all be full months.

**Step 6:**

Calculate one party's share. In this case, taxes are paid in arrears, so the seller owes the buyer for the seller's 102 days of ownership prior to the closing. The formula is always the same: \_\_\_\_\_.

The buyer owns the entire day of closing.

$$\$1,366 \div 365 \times 102 \text{ days} = \underline{\hspace{2cm}}$$

DEBIT \_\_\_\_\_, CREDIT \_\_\_\_\_

**Tip:** Remember the formula:

$$\text{total bill} \div \text{total days} \times \text{days owned} = \text{prorated amount}$$

**Always use the seller's last day to determine the number of days owned.** Cross off the person who pays the bill.

## EXERCISE: SETTLEMENT EXERCISE 1

### Creating the Closing Worksheet for Closing

- Using the information on this page (from the sales contract and other sources), prepare a six-column worksheet for this closing.

The closing will be April 13. The buyer is not getting a loan and is paying cash.

Some items will be prorated between the parties. These are ongoing expenses of the property. The seller will be responsible for some of the money and the buyer for the remainder.

Sales price (line 1).....	\$142,000
Deposit paid to broker (line 2).....	1,800
Title insurance premium (line 7).....	764
Closing fee split between the parties (line 8) .....	150
Notary charges per document signed (line 9) .....	1
Title examination by buyer's attorney (line 10).....	160
Recording warranty deed (line 11) .....	6
Documentary fee (line 15) .....	?
Tax certificate (line 16) .....	15
(shows the \$1,326 taxes for last year were paid) (line 17).....	memo
Don't forget the proration of taxes for the current year (line 18)	
Special assessment (that the seller has agreed to pay) (line 20) .....	1,700
New hazard insurance (line 23) .....	480
The unmetered water and sewer bill from March 1 through May 31 has been paid in the amount of (line 32).....	32
Broker's fee: 6% (line 37) .....	8,520

**Note:** The brokerage fees are for illustration only and are not intended to imply standard fees. Actual brokerage fees are negotiated between brokers and the sellers, buyers, landlords, or tenants who hire them.



## DISCUSSION OF SETTLEMENT EXERCISE 1

The following discussion works through Exercise 1. The numbers refer to the lines on which you enter debits and credits on the worksheets.

**1. Selling Price:** The selling price is \$142,000. Debit the buyer and credit the seller.

**2. Deposit, Paid to: Broker:** This is the buyer's earnest money deposit of \$1,800, which is payment toward the purchase price and reduces the money the buyer needs at closing. Credit the buyer and debit the broker.

**7. Title Insurance Premium:** This refers to the owner's policy and is paid by the seller. Debit the seller and credit the broker, who will pay the bill.

**8. Closing Fee:** This is the fee charged by the listing brokerage to close the transaction, and it is being split between the seller and buyer. Debit the buyer and seller one-half of the fee (\$75) each and credit the broker the full amount of \$150.

**9. Notary Fee:** This fee is charged to the party that is signing the document. In a cash closing, the only document that is notarized is the warranty deed, which is signed by the seller. No fee will appear on the buyer's worksheet. Debit the seller and credit the broker.

**10. Title Exam by Buyer's Attorney:** This line is for the fee for the buyer's attorney to review the title insurance commitment and advise the buyer on the merchantability of the title. The fee amount is \$160. Debit the buyer and credit the broker.

**11. Recording: Warranty Deed:** This benefits the buyer by providing constructive notice of the buyer's new ownership of the property. Debit the buyer \$6 and credit the broker.

**15. Documentary Fee:** This is a buyer's expense paid at the time of recording the warranty deed. It is calculated by moving the decimal point four places to the left in the selling price. The \$142,000 selling price yields a \$14.20 fee. Debit the buyer and credit the broker.

**16. Certificate of Taxes Due:** This refers to the certificate that is obtained from the county treasurer and confirms the current status of governmental taxes on the property. The buyer is assured that no other taxes are due. For this \$15 fee, debit the buyer and credit the broker.

**17. Taxes for Preceding Year(s):** In this exercise, the tax certificate shows that last year's taxes are already paid in the amount of \$1,326. It is customary to show a memo about this amount on line 17, but no debit or credit will show on either worksheet.

**18. Taxes for Current Year:** These are a proration between the seller and the buyer based on the \$1,326 taxes of the preceding year. Prorate as illustrated in the Proration Helper and enter the seller's share of the taxes as a credit to the buyer on line 18, with a corresponding debit to the seller.

**20. Special Taxes:** Line 20 refers to government special assessments. The Contract to Buy and Sell provides that the seller will pay off these assessments unless the buyer agrees to assume the obligation. Debit the seller and credit the broker.

**23. Premium for New Insurance:** This is for a new hazard insurance policy. The \$480 premium is the buyer's expense. Debit the buyer and credit the broker.



**32. Water and/or Sewer:** In this exercise, the unmetered water is already paid (in advance). Prorate the amount and charge (debit) the buyer for the buyer's ownership period. Debit the buyer and credit the seller.

**37. Broker's Fee:** This is typically paid by the seller. Debit the seller and credit the broker.

**Subtotals:** Carefully add the debit and credit columns.

Which subtotal is larger? Normally the buyer has greater debits than credits, which means the buyer will bring funds to the closing. The opposite is true for the seller, who should have greater credits than debits.

The difference between the buyer's debits and the buyer's credits is the balance due to/from buyer. Enter the amount on this line below the smaller of the two numbers (in this case, below the buyer's credits).

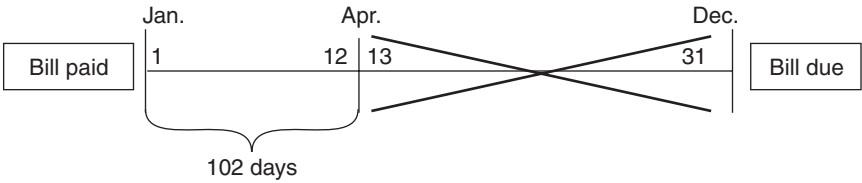
1. Enter the difference between the subtotals under the smaller (debit) number and complete the total line at the bottom of the sheet.
2. Complete the totals by adding the subtotal amounts to the balance due to/from buyer and balance due to/from seller. The result is equal totals for the buyer's and seller's two columns at the very bottom, which need to match. Now total the broker column. Note you will need to add the check from the seller total to the broker's credit (check out) column and the money brought by the buyer to the broker's debit (deposit in) column to balance the broker side.

	Seller		Buyer		Broker	
	Debit	Credit	Debit	Credit	Debit	Credit
Subtotals	11,430.55	142,017.04	142,767.24	2,170.55	1,800.00	11,810.20
Balance due to/ from seller	130,586.49					130,586.49
Balance due to/ from buyer				140,596.69	140,596.69	
Totals	142,017.04	142,017.04	142,767.24	142,767.24	142,396.69	142,396.69

Check the Buyer's Closing worksheet and the Proration Solutions to confirm your work on this part of the exercise.

PRORATION SOLUTIONS FOR SETTLEMENT EXERCISE 1

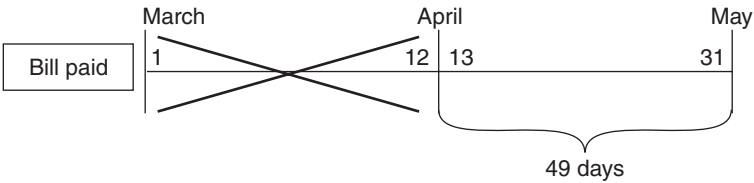
Line 18: Taxes for the preceding year were \$1,326.



Months	Days (seller owes)	
Jan.	31	
Feb.	28	
Mar.	31	
April	12	
	<u>102</u>	

$\$1,326.00 \div 365 \times 102 = \$370.55$   
 Debit seller, credit buyer

Line 32: Water and sewer costs equal \$32.



Months	Days (buyer owes)	
April	18	
May	31	
	<u>49</u>	

$\$32.00 \div 92 \times 49 = \$17.04$   
 Debit buyer, credit seller

	SELLER				BUYER				BROKER			
	Debit		Credit		Debit		Credit		Debit		Credit	
1. Selling Price			142,000	00	142,000	00						
2. Deposit, Paid to:							1,800	00	1,800	00		
3. Deed of Trust, Payable to:												
4. Deed of Trust, Payable to:												
5. Deed of Trust, Payoff to:												
6. Interest on Loan Assumed												
7. Owner Title Insurance Premium	764	00									764	00
8. Closing Fee	75	00			75	00					150	00
9. Notary Fee	1	00									1	00
10. Title Exam by Buyer Attorney					160	00					160	00
11. Recording: Warranty Deed					6	00					6	00
12. Deed of Trust												
13. Release												
14. Other												
15. Documentary Fee					14	20					14	20
16. Certificate of Taxes Due					15	00					15	00
17. Taxes for Preceding Year(s)												
18. Taxes for Current Year	370	55					370	55				
19. Tax Reserve												
20. Special Taxes/Assessments	1,700	00									1,700	00
21. Personal Property Taxes												
22. Notary Fee Paid by Lender												
23. Premium for New Insurance					480	00					480	00
24. Hazard Ins. Reserve												
25. FHA Mortgage Ins. Assumed												
26. FHA Mortgage Ins. Reserve												
27. Loan Origination												
28. Loan Discount Points												
29. Interest on New Loan												
30. Survey												
Credit Report												
31. Appraisal Fee												
32. Water and/or Sewer			17	04	17	04						
33. Rents												
34. Security Deposits												
35. Loan Transfer Fee												
36. Loan Payment Due												
37. Broker's Fee	8,520	00									8,520	00
38. Seller's Attorney												
39. Net Loan Proceeds												
Subtotals	11,430	55	142,017	04	142,767	24	2,170	55	1,800	00	11,810	20
Balance Due TO/From Seller	130,586	49									130,586	49
Balance Due TO/FROM Buyer							140,596	69	140,596	69		
TOTALS	142,017	04	142,017	04	142,767	24	142,767	24	142,396	69	142,396	69

**EXERCISE: SETTLEMENT EXERCISE 1B**

- Using the information on this page (from the sales contract and other sources), prepare a six-column worksheet for this closing. You can use a six-column worksheet from the back of your book.

The closing will be June 12. The buyer is not getting a loan and is paying cash.

Some items will be prorated between the parties. These are ongoing expenses of the property. The seller will be responsible for some of the money and buyer for the remainder.

Sales price (line 1).....	\$245,000
Deposit paid to broker (line 2).....	\$2,500
Title insurance premium (line 7).....	1,230
Closing fee split between the parties (line 8) .....	360
Notary charges per document signed (line 9) .....	1
Title examination by buyer's attorney (line 10).....	160
Recording warranty deed (line 11) .....	6
Documentary fee (line 15) .....	?
Tax certificate (line 16) .....	15
(shows the \$1,745 taxes for last year were paid) (line 17).....	memo
Don't forget the proration of taxes for the current year (line 18)	
Special assessment (that the buyer has agreed to assume) (line 20).....	670
New hazard insurance (line 23) .....	530
The unmetered water and sewer bill from April 1 through June 30 has been paid in the amount of (Line 32) .....	
	230
Broker's fee: 6% (line 37) .....	?

**Note:** The brokerage fees are for illustration only and are not intended to imply standard fees. Actual brokerage fees are negotiated between brokers and the sellers, buyers, landlords, or tenants who hire them.

	SELLER				BUYER				BROKER			
	Debit		Credit		Debit		Credit		Debit		Credit	
1. Selling Price			245,000	00	245,000	00						
2. Deposit, Paid to:							2,500	00	2,500	00		
3. Deed of Trust, Payable to:												
4. Deed of Trust, Payable to:												
5. Deed of Trust, Payoff to:												
6. Interest on Loan Assumed												
7. Owner Title Insurance Premium	1,230	00									1,230	00
8. Closing Fee	180	00			180	00					360	00
9. Notary Fee	1	00									1	00
10. Title Exam by Buyer Attorney					160	00					160	00
11. Recording: Warranty Deed					6	00					6	00
12. Deed of Trust												
13. Release												
14. Other												
15. Documentary Fee					24	50					24	50
16. Certificate of Taxes Due					15	00					15	00
17. Taxes for Preceding Year(s)												
18. Taxes for Current Year	774	49					774	49				
19. Tax Reserve												
20. Special Taxes/Assessments	0										0	
21. Personal Property Taxes												
22. Notary Fee Paid by Lender												
23. Premium for New Insurance					530	00					530	00
24. Hazard Ins. Reserve												
25. FHA Mortgage Ins. Assumed												
26. FHA Mortgage Ins. Reserve												
27. Loan Origination												
28. Loan Discount Points												
29. Interest on New Loan												
30. Survey												
Credit Report												
31. Appraisal Fee												
32. Water and/or Sewer			48	02	48	02						
33. Rents												
34. Security Deposits												
35. Loan Transfer Fee												
36. Loan Payment Due												
37. Broker's Fee	14,700	00									14,700	00
38. Seller's Attorney												
39. Net Loan Proceeds												
Subtotals	16,885	49	245,048	02	245,963	52	3,274	49	2,500	00	17,026	50
Balance Due TO/ <del>From</del> Seller	228,162	53									228,162	53
Balance Due <del>To</del> /FROM Buyer							242,689	03	242,689	03		
TOTALS	245,048	02	245,048	02	245,963	52	245,963	52	245,189	03	245,189	03

## DISCUSSION OF SETTLEMENT EXERCISE 1B

The following discussion works through Exercise 2. The numbers refer to the lines on which you enter debits and credits on the worksheets.

**1. Selling price:** The selling price is \$245,000. Debit the buyer and credit the seller.

**2. Deposit, paid to: (broker):** This is the buyer's earnest money deposit of \$2,500, which is payment toward the purchase price and reduces the money the buyer needs at closing. Credit the buyer and debit the broker.

**7. Title insurance premium:** This refers to the owner's policy, which is paid by the seller. Debit the seller and credit the broker, who will pay the bill.

**8. Closing fee:** This is the fee charged by the title company to close the transaction, and it is being split between the seller and buyer. Debit the buyer and seller one-half of the fee (\$180) each and credit the broker the full amount of \$360.

**9. Notary fee:** This fee is charged to the party that is signing the document. In a cash closing, the only document that is notarized is the warranty deed, which is signed by the seller. No fee will appear on the buyer's worksheet. Debit the seller and credit the broker.

**10. Title exam by:** This line is for the fee for the buyer's attorney to review the title insurance commitment and advise the buyer on the merchantability of the title. The fee amount is \$160. Debit the buyer and credit the broker.

**11. Recording: warranty deed:** This benefits the buyer by providing constructive notice of the buyer's new ownership of the property. Debit the buyer \$6 and credit the broker.

**15. Documentary fee:** This is a buyer's expense paid at the time of recording the warranty deed. It is calculated by moving the decimal point four places to the left in the selling price. A \$245,000 selling price yields a \$24.50 fee. Debit the buyer and credit the broker.

**16. Certificate of taxes due:** This refers to the certificate that is obtained from the county treasurer and confirms the current status of governmental taxes on the property. The buyer is assured that no other taxes are due. For the \$15 fee, debit the buyer and credit the broker.

**17. Taxes for preceding year(s):** In this exercise, the tax certificate shows that last year's taxes are already paid in the amount of \$1,745. It is customary to show a memo about this amount on line 17, but no debit or credit will show on either worksheet.

**18. Taxes for current year:** These are a proration between the seller and the buyer based on the \$1,745 taxes of the preceding year. Prorate as illustrated in the Proration Helper and enter the seller's share of the taxes as a credit to the buyer on line 18, with a corresponding debit to the seller.

**20. Special taxes:** Line 20 refers to government special assessments. The Contract to Buy and Sell provides that the buyer will assume these assessments. Since no money is changing hands at the closing, it will not show up on the six-column worksheet.

**23. Premium for new insurance:** This is for a new hazard insurance policy. The \$530 premium is the buyer's expense. Debit the buyer and credit the broker.

**32. Water and/or sewer:** In this exercise, the unmetered water is already paid (in advance). Prorate the amount and charge (debit) the buyer for the buyer's ownership period. Debit the buyer and credit the seller.

**37. Broker's fee:** This is typically paid by the seller. Debit the seller and credit the broker.

**Subtotals:** Carefully add the debit and credit columns.

Which subtotal is larger? Normally the buyer has greater debits than credits, which means the buyer will bring funds to closing. The opposite is true for the seller, who should have greater credits than debits.

The difference between the buyer's debits and the buyer's credits is the balance due to/from buyer. Enter the amount on this line below the smaller of the two numbers (in this case, below the buyer's credits).

1. Enter the difference between the subtotals under the smaller (debit) number and complete the total line at the bottom of the sheet.
2. Complete the totals by adding the subtotal amounts to the balance due to/from buyer and balance due to/from seller. The result is equal totals for the buyer's and seller's two columns at the very bottom, which need to match. Now total the broker column. Note you will need to add the check from the seller total to the broker's credit (check out) column and the money brought by the buyer to the broker's debit (deposit in) column to balance the broker side.

	Seller		Buyer		Broker	
	Debit	Credit	Debit	Credit	Debit	Credit
Subtotals	16,885.49	245,048.02	245,963.52	3,274.49	2500.00	17,026.50
Balance due to/from seller	228,162.53					228,162.53
Balance due to/from buyer				242,689.03	242,689.03	
Totals	245,048.02	245,048.02	245,963.52	245,963.52	245,189.03	245,189.03

## HOMEWORK BEFORE UNIT 2

Using Settlement Exercise 1B, see if you can do the closing worksheet and balance all six columns on your own. You can use one of the blank six-column worksheets provided in the back of this book.

Read Unit 1, if you have not already done so, and complete the Unit 1 glossary review.





# UNIT 2

## How Loans Affect the Buyer and Seller

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Summarize how loans affect a closing worksheet.
- › Calculate other prorations used in closings.
- › Describe the “rules” for allocating expenses in a settlement.

### KEY TERMS

assumption balance  
certificate of taxes due  
hazard insurance

lender reserve/impound  
account  
loan assumption  
notary fee

seller-carry financing  
special taxes/assessments  
VA loan

### OVERVIEW

#### Loans

Brokers should be familiar with the following two types of loans:

- New loans
- Assumptions

A new loan begins on the day of closing. In an assumption, the buyer takes over (assumes) responsibility for the existing loan originated by the seller.

Most buyers finance their purchase with a new loan. For a new loan, the buyer will make a loan application and provide a credit report. The lender will normally require an appraisal, perhaps a survey, and most likely a mortgagee's (lender's) title insurance policy. The lender may charge a loan origination fee, charge discount points based on the loan amount, or both. New loans may

be conventional, VA-guaranteed, FHA-insured, or seller-carry loans. Each of these loan types may have specific fees or requirements unique to that loan program. Loan closing costs are normally the buyer's responsibility (buyer debits). (We will discuss new loans in Unit 3.)

An assumed loan (**loan assumption**) is an existing loan originally taken out when the seller purchased the home. If the lender agrees, or the terms of the original loan permit, the responsibility for the loan may be shifted to the buyer at closing. There may be a loan transfer fee, but there will not be a loan origination fee or discount points at the time the loan is assumed. Most lenders will not require an appraisal or a survey, and the lender's title insurance is already in place, so there is no additional cost. In a rising interest rate market, an assumable loan that is a few years old may be an attractive marketing tool. By taking over the existing loan, the buyer uses the remaining balance at the time of closing as primary financing for the purchase.

If the seller's loan is several years old, the property may have appreciated and the loan balance reduced from the original loan amount. The buyer must come up with the difference between the assumed loan balance and the purchase price (the seller's equity). In that case, the seller may be willing to allow the buyer to pay for some of the seller's equity in the form of a **seller-carry** second loan. The seller agrees to accept the buyer's promissory note and record a deed of trust, which will be in second position behind the original deed of trust. The seller-carry loan helps the buyer with the down payment money but reduces the cash available to the seller at closing.



#### FOR EXAMPLE

Sales price	\$230,000
Assumed loan	<u>− 175,000</u>
Seller's equity	55,000
Buyer down payment	25,000
New seller-carry loan	30,000

## Loan Figures

For a closing, the lender's figures will be provided to the broker in a New Loan Statement (for new loans) or a Loan Assumption Statement (for an assumption). Any figures presented in these statements must be used exactly as provided in the closing documents.

A broker who thinks the figures in a lender's New Loan Statement or Loan Assumption Statement are incorrect should do the following:

- Verify with the employing broker or closer that the figures are incorrect.
- Call the lender to get the figures checked (only the lender can change them).

## Closing With an Assumed Loan

### *The Loan Assumption Statement*

The lender for the loan to be assumed supplies a statement of the current status of the loan. These figures must be used exactly as provided to calculate the closing adjustments (debits and credits).

## Assumption Items

### ***Loan Being Assumed (Line 3. Deed of Trust, Payable to: Existing Lender)***

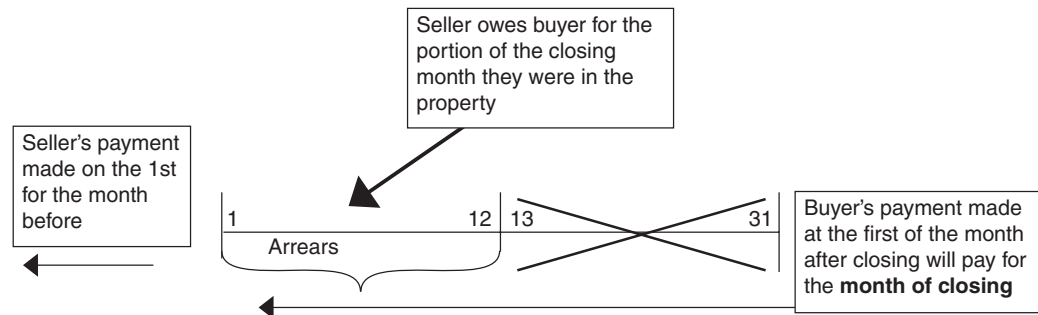
This is the current principal balance of the first deed of trust or mortgage that is being assumed as of the month of closing. This loan is a debt the seller needs to clear and reduces the amount of money the seller will take away from the closing (debit seller). The buyer's assumption of the loan results in a buyer credit at closing (reducing the amount of money the buyer needs to bring to the closing). The buyer will take over payment of the loan after the closing.

- For an assumed loan, debit the seller and credit the buyer.

		SELLER		BUYER	
		Debit	Credit	Debit	Credit
3	Deed of Trust, Payable to: LMT Mortgage	XXX.XX			XXX.XX

### ***Interest on Loan Assumed***

Interest on loans is paid in arrears (i.e., the interest for a given month is due at the end of the month and the interest is included in the next month's payment). Since interest is collected in arrears, in an assumable loan the seller always owes the buyer the interest for the month of closing. (The exception would be a closing on the first of the month, when the seller would owe nothing provided that month's payment has been made.)



The seller always owes interest to the buyer for the month of closing if a loan is assumed.

1. Balance of existing loan  $\times$  interest rate = one year's interest.
2. One year's interest  $\div$  12 = one month's interest.
3. Prorate one month's interest amount by actual days within the month of closing.

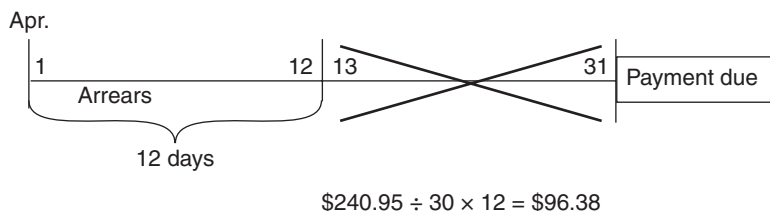


#### **FOR EXAMPLE**

A buyer is assuming a loan balance of \$36,143.24 on an 8% VA-guaranteed loan. What is the settlement entry for interest at a closing on April 13?

The monthly interest for April can be calculated as follows:

$$\$36,143.24 \times 0.08 \div 12 = \$240.95$$



- Always debit the seller and credit the buyer.

**Special rule:** On assumed loans, the interest is always divided by 12 months, since the loan payments have been amortized for the full loan. An assumed loan is the only time 12 months is used; in other interest proration calculations use 365 days. This is the formula:

$$\text{loan amount} \times \text{interest rate} \div 12 \div \text{days in month of closing} \times \text{days owned by the party who owes} = \text{proration amount}$$

**Line 9. Notary Fees:** Notary fees are charged for having a witness (the notary) acknowledge the signing of a document. The party signing gives evidence of her identity and the fact that she is signing willingly.

The party who signs the document pays for the notary fee.

- A warranty deed is signed by the seller.
  - Always debit the seller for this notary fee.
- A deed of trust (trust deed) is signed by the buyer.
  - Always debit the buyer for this notary fee.

**Line 33. Water and/or Sewer:** The proration of water and sewer charges must comply with the contract and the billing method. There are two common possibilities:

- Metered bill: The closer/broker will order the account to be switched to the buyer as of the date of closing. The seller will owe for the water used to the day of closing. Since that bill is not yet available, the broker withholds an adequate amount from the seller's proceeds to cover the bill. The amount withheld will show up on the seller's closing statement. The closer/broker will pay the bill when it arrives and return any excess to the seller.
- Unmetered bill: This is paid as a flat rate either in advance or in arrears. Payment in advance is more common, but read the information provided by the utility, or in a test problem, carefully to determine whether it is paid in advance or in arrears.

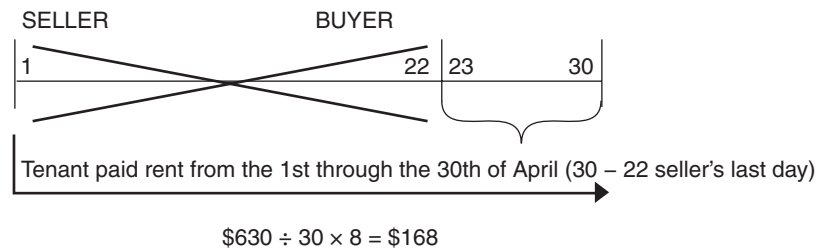
## Rental Properties

The sale of rental properties creates the need to account for items related to the tenants—primarily, rents and security deposits.

**Line 33. Rents:** Rent is collected from a tenant on the first of the month in advance for that month. The buyer will want to be given a share of the rent. **Remember:** Since the buyer will not have possession, he will expect the rent that is owed to him. Typically, this means the rent needs to be prorated. A tenant pays rent in advance, and the seller will be required to credit the buyer for the portion of the month the buyer owns the property. Rent is always a debit to the seller and a credit to the buyer.

**FOR EXAMPLE**

The closing date is April 23. Monthly rent is paid from April 1 to April 30 in the amount of \$630.



- Always debit the seller and credit the buyer the prorated share.

**Line 34. Security Deposits:** The seller is holding all security deposits. This tenant's money is transferred in full to the new owner at the closing (debit the seller and credit the buyer the full amount). The Contract to Buy and Sell requires the seller to notify the tenants as to who is holding the security deposit.

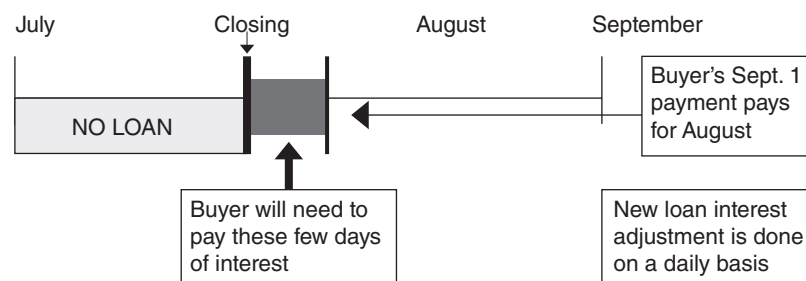
- Always debit the seller and credit the buyer the full amount.
- Never prorate security deposits.

**Line 4. Deed of Trust, Payable to: seller-second or seller-carry**

- If a second deed of trust is to exist on the property after the closing, such as a seller-carryback, this needs to be included in the closing figures. The seller will receive this amount after closing from payments made by the buyer, but the seller will not receive this as money at closing. **Remember:** The closing represents only funds brought to, or given out, on closing day.
- Always debit the seller and credit the buyer the full amount of the seller-carry loan.

**Line 29. Interest on New Loan or Seller-Carry Second:** In a new or seller-carry loan, because the ongoing monthly payments are amortized, the buyer will often owe the lender interest for the month of closing. In a seller-carry loan, the buyer will owe the seller (lender) this interest. The amount is for the days the buyer owns the property for the month of closing only. This is not a proration since it is money the buyer owes the lender and is not a bill being divided between the two parties. Interest is the buyer's responsibility because the loan starts as of the day of closing.

- Always debit the buyer (borrower) and credit the seller (lender) for the days owed for the month of closing.

**FOR EXAMPLE**

Use the following formula:

$$\text{amount of new loan} \times \text{interest rate} \div 365 \times \text{days owed}$$



#### FOR EXAMPLE

Consider a seller- carry loan of \$25,000 at 6% interest. The buyer owes five days for the month of closing. Using the formula given earlier, the answer is calculated as follows:

$$\$25,000 \times .06 \div 365 \times 5 = \$20.55$$

Debit the buyer \$20.55 and credit the seller \$20.55.

**Note:** This method is not the same as the calculation of interest on the loan assumed in the closing! This is done using 365 days.

## Buyer and Seller Transfers

As we have discussed before, many entries for a settlement involve just the buyer and seller. These are buyer and seller transfers of funds carried out on the six-column worksheet as part of the closing. Amounts are then summarized in the subtotals and totals at the bottom of the worksheet to determine the final funds needed for closing.

## Review of Debits (Items Owed) and Credits (Amounts Received)

- **Sales price:** credit seller/debit buyer
- **Loan assumption balance:** debit seller/credit buyer
- **Seller-carry loan amount:** debit seller/credit buyer
- **Security deposits:** debit seller/credit buyer
- **Interest adjustment on a new or seller-carry loan:** credit seller/debit buyer
- **Prorations:**
  - **Interest on a loan assumed: (SOB)** debit seller/credit buyer
  - **Taxes for the current year: (SOB)** debit seller/credit buyer
  - **Rents: (seller always owes buyer)** debit seller/credit buyer
  - **HOA dues:** usually paid in advance, so credit seller/debit buyer
  - **Flat rate water and/or sewer: advance (BOS) or arrears (SOB)**

## Buyer Settlement Items

Many items are buyer-only items and do not affect the seller. These are mostly fees or obligations due to a person or company outside of the closing. As we saw in Unit 1, these are usually reflected in the broker's column as credits to be paid. The broker or new lender will process payments to outside service providers.

Buyer settlement entries that affect only the buyer's closing statement include the following:

- **Earnest money deposits:** credit buyer, because it will be deducted from the purchase price; debit broker's trust account, since this is where it was deposited and has been held
- **Buyer's attorney:** debit buyer to pay for this legal service; credit broker to pay the bill
- **Closing fee as negotiated in the contract:** debit buyer per terms; credit broker
- **Notary fee:** debit buyer for the deed of trust; credit broker
- **Recording the warranty deed:** debit buyer, since the buyer benefits from the constructive notice provided by recording; credit broker to pay the bill
- **Recording a new deed of trust:** debit buyer, since the lender requires a deed of trust be signed at closing; credit broker to pay the bill
- **Documentary fee:** debit buyer by state law and because it will have to be paid at the time the warranty deed is recorded; credit broker to pay the bill
- **Tax certificate:** debit buyer as a benefit and future guarantee; credit broker to pay the bill
- **Loan fees and costs (normally all buyer debits):**
  - Mortgagee's title insurance
  - Loan origination fee
  - Loan discount points
  - Loan transfer fee
  - Appraisal (typically paid by the buyer, but negotiable in the contract)
  - Survey (negotiable in the contract)
  - Closing fee

Many of these debits will be paid by the lender in a new loan and reported to the broker/closer, which we will discuss later in the unit.

## Seller Settlement Items

These items affect the seller's closing statement and not the buyer's. Again, the broker or new lender will make payments to outside service providers.

Seller settlement entries include the following:

- **Deed of trust payoff:** for a new loan closing, debit seller to remove the lien
- **Owner's title insurance:** debit seller per terms of Contract to Buy and Sell Real Estate; credit broker to pay the bill
- **Closing fee as negotiated in the contract:** debit seller per terms; credit broker
- **Notary fee:** debit seller for the warranty deed; credit broker
- **Seller's attorney:** debit seller for this legal service; credit broker to pay the bill

- **Recording release of deed of trust:** debit seller to remove the lien; credit broker to pay the bill
- **Taxes for the preceding year (if unpaid):** debit seller since the seller had possession of the year; credit broker the full amount owed to pay the bill/lien
- **Loan payment due:** debit seller the full amount of loan payment due; credit broker to pay the bill
- **Broker's fee:** debit seller per terms of the listing contract; credit broker
- **Security deposit:** since the security deposit belongs to the tenant, debit seller the full amount and transfer to the buyer/new landlord (credit buyer)
- **Prorations:**
  - Taxes for the current year: debit seller/credit buyer (SOB)
  - Flat rate water and/or sewer: advance (BOS) or arrears (SOB)
  - Rents: debit seller/credit buyer (SOB)
  - HOA dues: usually in advance (BOS), so credit seller/debit buyer

### Broker Items Shown on the Worksheet

The last two columns of the six-column Settlement Closing worksheet represent the broker's escrow or trust account. The broker's two columns have the following meanings:

- **Debit** (deposit **into** the broker's escrow or trust account)
- **Credit** (check **out of** the broker's escrow or trust account)

### ***Debit (deposit into the closer/broker's escrow or trust account)***

A debit represents money deposited (or paid in) and held by the broker in the company's escrow or trust account, or held by the closer in the title company escrow account, until the day of closing. The money is held in trust for others and the broker owes it to someone; therefore, it is a broker debit. There are only two broker debits we would expect to see in the main part of the worksheet above the total lines:

- **Line 2. Deposit, Paid to:** This is the earnest money deposit (money provided by the buyer to the broker before closing).
- **Line 39. Net Loan Proceeds:** This applies only in the case of a new loan. It is the net amount sent to closing by a new lender so the closer/broker can pay bills and write a check to the seller.

		BROKER		
		Debit	Credit	
2	Earnest Money Deposit	XXX		
39	New Loan Net Loan Proceeds	XXX		

If the buyer (or seller, in rare instances) will be bringing good funds to the closing, this will show up as a broker debit/deposit on the balance due to/from line (below the double line) for the respective party. It must be deposited *into* the trust account or the broker will not have sufficient money to complete the closing.



### ***Credit (check out of the closer/broker's escrow account)***

A credit represents a check written (an amount paid out) from the closer/broker's escrow or trust account for that transaction. Writing a check to pay a bill on behalf of the buyer or seller reduces the money held for others, making the amount a broker credit (think check out of the account).

When the closing worksheet is completed, the broker will have written checks in an amount equal to the money that was deposited in the escrow account, so the ledger for the transaction will have a zero balance.

### **Typical Broker Credits**

Debit From:		Debit		Credit	
Seller	Owner's title insurance premium			XXX	XX
Either	Extended title insurance premium			XXX	XX
Either	Title exam by (attorney's fees)			XXX	XX
Either	Closing fees			XXX	XX
Both	Notary fees			XXX	XX
Buyer	Recording: warranty deed			XXX	XX
Buyer	Recording: trust deed			XXX	XX
Buyer	Documentary fee			XXX	XX
Buyer	Certificate of taxes due			XXX	XX
Seller	Taxes for the preceding year(s)			XXX	XX
Seller	Special taxes			XXX	XX
Buyer	Premium for new insurance			XXX	XX
Buyer	Loan origination fee			XXX	XX
Buyer	Loan discount points			XXX	XX
Either	Survey			XXX	XX
Buyer	Credit report			XXX	XX
Either	Appraisal fee			XXX	XX
Buyer	Loan transfer fee			XXX	XX
Seller	Loan payment due			XXX	XX
Seller	Broker's fee			XXX	XX

Each of these credits represents an amount the broker will pay out on behalf of one of the parties to the transaction.

Broker debit = \$ deposit into trust account

Broker credit = \$ check out of trust account

The broker's fee is a debit to the seller and a credit to the broker. **Remember:** The broker has to write a check for the commission from the brokerage escrow account and deposit it into the brokerage operations account in order to write commission checks to a broker-associate and to avoid commingling of funds.

## What Is Entered in the Broker's Columns?

Whenever there are funds deposited in the broker's escrow or trust account, there will be a broker debit (deposit) noted. Whenever the closer/broker writes a check out of the broker's escrow or trust account, there will be a broker credit.

All items in a closing will be handled by the closer/broker except any buyer/seller debits or credits in the new loan statement, which are handled by the lender.

## Review of How to Find the Subtotal and Total for Each Column

Closing Worksheet Exercise 3		Closing: September 26		Seller has 25 days, buyer has 5 days					
	SELLER			BUYER			BROKER		
	Debit	Credit		Debit	Credit		Debit	Credit	
Subtotals	287,700	62	300,027	40	301,090	40	273,569	62	1,500 00
Balance Due TO/From Seller	12,326	78							16,694 00
Balance Due TO/FROM Buyer					27,500	78	27,520	78	12,326 78
Totals	300,027	40	300,027	40	302,090	40	29,020	78	29,020 78

Balance Due TO Seller:  
Subtract the debit from the credit subtotal. Once determined, put it in the broker credit column, as this is the amount the broker will have to write as a check to the seller for the net proceeds.

Balance Due FROM Buyer:  
Subtract the credit from the debit subtotal. Once determined, put it in the broker debit column, as this is the amount the broker will have to collect (deposit) from the buyer.

If the broker columns do not balance, check the seller and buyer columns. See the Balance Helper at the end of chapter.

## Seller's Subtotal and Total With the Broker's Credit Total

	SELLER			BROKER		
	Debit	Credit		Debit	Credit	
Subtotals	287,700	62	300,027 40			16,694 00
Balance Due TO/From Seller	12,326	78				12,326 78
Balance Due TO/FROM Buyer						
Totals	300,027	40	300,027 40			29,020 78

The seller's subtotals are all the debits and credits from the seller columns after everything has been entered. Typically, the seller's credit subtotal is larger than the debit subtotal, meaning the seller will be receiving money at the closing table. Subtract the debit from the credit to determine how much is due the seller. Once complete, transfer the amount across to the broker credit column, as this represents the check the broker will have to write to the seller. Now total the broker credit column and add the seller's check amount to get the broker credit total.

## Buyer's Subtotal and Total With the Broker's Debit Total

Closing Worksheet		Closing: September 26				Seller has 25 days, Buyer has 5 days										
				SELLER				BUYER				BROKER				
				Debit		Credit		Debit		Credit		Debit		Credit		
Subtotals								301,090	40	273,569	62		1,500	00	16,694	00
Balance Due TO/From Seller:															12,326	78
Balance Due To/FROM Buyer										27,500	78	→	27,520	78		
Totals								302,090	40	302,090	40		29,020	78	29,020	78

Must match to balance

The buyer's subtotals are all the debits and credits from the buyer's columns after everything has been entered. Typically, the buyer's debit subtotal is larger than the credit subtotal, meaning the buyer will bring money to the closing table. After you have determined how much is due from the buyer, transfer this amount across to the broker debit column, as this represents the deposit of funds into broker's account so he will have the money to write the check to the seller. Now, total the broker debit column by adding the buyer's check amount to get the broker debit total. This must match the total from the broker's credit column or the worksheet doesn't balance.

## Types of Closing Worksheet Entries

All entries on the settlement closing worksheet fall into one of three categories:

1. Seller and buyer transfer of funds
  - The selling price and prorations are examples of this.
  - For these entries, each line will have two offsetting entries. There must be an equal dollar value of debits and credits (e.g., \$100 debit seller, \$100 credit buyer—not \$150 debit seller, \$100 credit buyer).
2. Funds held by the broker until the closing of a transaction
  - Earnest money is the most common example.
  - It is a credit to the buyer and a debit to the broker (deposit into the escrow account). Once again, there must be an offsetting dollar value of debit and credit entries.
3. Bills paid by the broker on behalf of the seller or buyer
  - Recording fees and attorney's fees are good examples.
  - These are a debit to the party responsible for the item and a credit to the broker (out of the broker's escrow or trust account) for writing the check. There must be equal debit and credit dollar value entries again, except in new loans.

## SETTLEMENT CLOSING WORKSHEET TIPS—ASSUMPTION LOANS

**General rule:** ♦ = *proration items*    *Arrears* = *SOB (left side)*    *Advance* = *BOS (right side)*

**Broker controls and pays. Debit and credit dollar values must be equal.**

	Debit / Credit	Tips
1. Selling Price	Credit seller/debit buyer	
2. Deposit, Paid to:	Credit buyer/debit broker	
3. Deed of Trust, Payable to:	Debit seller/credit buyer	Seller's existing loan being assumed
4. Deed of Trust, Payable to: <i>seller</i>	Debit seller/credit buyer	If seller is carrying back a portion of the selling price
5. Deed of Trust, Payoff to:	N/A	
6. ♦ Interest on Loan Assumed	Debit seller/credit buyer	SOB (solve left side)
7. Title Insurance Premium	Debit seller/credit broker	
a. Extended Title Insurance		
b. Mortgagee's Policy		
8. Closing Fee	Debit seller and/or buyer/credit broker	Verify how this is charged in the contract
9. Notary	Debit seller and buyer/credit broker	Charge the person who signs the document
10. Title Exam by: Buyer's Attorney	Debit buyer/credit broker	
11. Recording:     Warranty Deed	Debit buyer/credit broker	
12.             Deed of Trust: New 2nd	Debit buyer/credit broker	
13.             Release	N/A	
14.             Other	(depends on contract)	Analyze carefully
15. Documentary Fee	Debit buyer/credit broker	Must have $0.0001 \times$ the sale price
16. Certificate of Taxes Due	Debit buyer/credit broker	
17. Taxes for Preceding Year(s)	Debit seller/credit broker	If unpaid
18. ♦ Taxes for Current Year	Debit seller/credit buyer	SOB (solve left side)
19. Tax Reserve	Credit seller/debit buyer	Assumption loan only
20. Special Taxes	Debit seller/credit broker	If paid; if assumed, no entry
21. Personal Property Taxes	N/A	
22. Hazard Ins. Prem.—Assumed	N/A	
23. Premium for New Hazard Insurance	Debit buyer/credit broker	
24. Hazard Insurance Reserve	N/A	
25. FHA Mortgage Insurance—Assumed	N/A	
26. FHA Mortgage Insurance Reserve	N/A	
27. Loan Origination	N/A	New loans only
28. Loan Discount Points	N/A	New loans only
29. Interest on New Loan	Debit buyer/credit seller	Seller-carry calculation
30. Survey	(depends on contract)	Analyze carefully
Credit Report	Debit buyer/credit broker	
31. Appraisal Fee	(depends on contract)	Analyze carefully
32. ♦ Water and/or Sewer	(depends on how this is billed: in advance or arrears)	Analyze carefully

33. ♦ Rents	Debit seller/credit buyer	Seller always owes buyer—solve right side
34. Security Deposits	Debit seller/credit buyer	The full amount
35. Loan Transfer Fee	Debit buyer/credit broker	
36. Loan Payment Due	Debit seller/credit broker	Never prorate
37. Broker's Fee	Debit seller/credit broker	From the listing contract
38. Seller's Attorney	Debit seller/credit broker	
39. Net Loan Proceeds (from lender)	N/A	New loans only; debit broker
♦ Homeowners Association Fees	(depends on how this is billed: in advance or arrears)	Analyze carefully
<b>Subtotals</b>		
Balance Due To/From Seller		
Balance Due To/From Buyer		
<b>TOTALS</b>		

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price (linked to Line 15)						
2. Deposit, Paid to:						
3. Deed of Trust, Payable to: (linked to Line 6)						
4. Deed of Trust, Payable to: (linked to Line 29)						
5. Deed of Trust, Payoff to:						
6. Interest on Loan Assumed						
7. Title Insurance Premium						
8. Closing Fee						
9. Notary Fee						
10. Title Exam by Buyer's Attorney						
11. Recording: Warranty Deed						
12. Deed of Trust						
13. Release						
14. Other						
15. Documentary Fee						
16. Certificate of Taxes Due						
17. Taxes for Preceding Year (linked to Line 18)						
18. Taxes of Current Year						
19. Tax Reserve						
20. Special Taxes						
21. Personal Property Taxes						
22. Hazard Ins. Premium Assumed						
23. Premium for New Insurance						
24. Hazard Ins. Reserve						
25. FHA Mortgage Ins. Assumed						
26. FHA Mortgage Ins. Reserve						
27. Loan Origination Fee (Buyer)						
28. Loan Discount Points (Buyer)						
29. Interest on New Loan						
30. Survey						
31. Appraisal Fee						
32. Water and/or Sewer						
33. Rents						
34. Security Deposit						
35. Loan Transfer Fee						
36. Loan Payment Due						
37. Broker's Fee						
38. Seller's Attorney						
Subtotals						
Balance Due To/From Seller						

Annual interest ÷ 12 then prorate

Move decimal 4 to the left

Annual interest ÷ 365 then days owed

Seller always owes buyer from closing to end of month

Place the balancing figures under the lower of the debit and credit subtotals (for both the buyer and seller). Remember to match that entry with an opposing debit or credit in the broker columns. Everything under the subtotal line is just a process for making the closing worksheet balance.

## SUMMARY

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Information for a closing can come from many sources. A broker must be able to extract and coordinate information from lenders, from the Contract to Buy and Sell, and directly from the parties.

Figures stated in any lender's statement (Loan Assumption Statement or New Loan Statement) must be used exactly as provided.

There are two types of interest calculations: interest proration on a loan being assumed and interest adjustment on a seller-carry. It is important to be able to differentiate between the two calculations. **Remember:** For assumed loans divide annual interest by 12 months, and for new loans divide annual interest by 365 days.

Many of the items listed on a six-column worksheet are buyer/seller exchanges (transfers of money between the buyer and seller). The rest are bills that have to be paid and will be a credit to the broker, who will pay them.

## UNIT 2: GLOSSARY REVIEW

Match the terms with the definitions. Terms may be used more than once.

assumption balance	hazard insurance
certificate of taxes due	lender reserve/impound account
credit	loan assumption
debit	notary fee
documentary fee	seller-carry financing
FHA loan	special taxes/assessments
FHA mortgage insurance	VA loan

1. The document from the county treasurer reporting the current status of taxes due on a property is the \_\_\_\_\_.
2. A loan from the seller to the buyer to help finance the sale is referred to as \_\_\_\_\_.
3. The fee paid to have the signature on a document witnessed and affirmed is the \_\_\_\_\_.
4. A loan guaranteed by a government agency is a \_\_\_\_\_.
5. A lender may hold borrower's funds to pay future bills such as taxes and insurance in \_\_\_\_\_.
6. The exact amount of the \_\_\_\_\_ reported by the existing lender is a CREDIT to the buyer at closing.
7. \_\_\_\_\_ protects the owner from fire and other casualty losses.
8. \_\_\_\_\_ or localized improvements by the government will normally be paid off by the seller at closing.
9. A \_\_\_\_\_ in the broker's column typically represents a DEBIT from a buyer or seller.
10. When a buyer takes over responsibility for the seller's loan to help pay the purchase price of a property, this type of closing is called a \_\_\_\_\_ closing.

## LECTURE OUTLINE

### I. ASSUMPTIONS AND SELLER-CARRY LOANS: THE BIG PICTURE

- In Unit 1, the listing brokerage firm used its trust account to close a cash real estate transaction between the seller and the buyer.
- In Unit 2, the buyer will pay for the real estate by assuming the seller's existing senior loan, obtaining a new junior loan from the seller, and paying the balance due from the buyer in good funds.
- In a real estate transaction that involves a loan assumption and seller-carry loan, the broker uses its trust account to close three separate transactions on one six-column Real Estate Settlement Worksheet:
  1. The real estate transaction between the seller and the buyer
  2. The loan assumption transaction among the seller, the buyer, and the seller's existing lender
  3. The seller-carry loan transaction between the seller and the buyer

### II. ASSUMPTION AND SELLER-CARRY LOANS

Rules for loan transactions:

- Mortgage interest is paid in \_\_\_\_\_.
- Payments are made on the \_\_\_\_\_ of the month (unless otherwise stated).

#### A. Loan Assumption Statement

1. Includes all of the items related to the loan being assumed.
2. Use figures exactly as provided by the lender.
3. Assumed Loans: (Line 3. Deed of Trust Payable to)

The amount for the loan being assumed will always

- a. be a seller \_\_\_\_\_ because this is a loan that is owed and will not be part of the funds the seller will receive for the sale;
  - b. be a buyer \_\_\_\_\_ because the buyer is taking over the loan and will not have to bring this amount of money to closing to pay for the property; and
  - c. appear on both settlement statements.
4. When a loan is being assumed, expect to see a \_\_\_\_\_ of interest for the month of closing. The seller will owe the buyer for the time in the property.

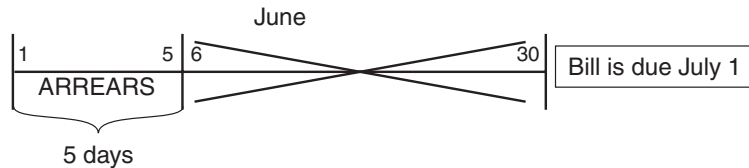


**B. Prorating Interest on an Assumed Loan (Line 6. Interest on Loan Assumed)**

1. A loan of \$250,000 at 6% will be assumed by the buyer.

$$\$250,000 \times 0.06 \div 12 = \$1,250 \text{ per month}$$

Prorate the interest for a closing on June 6.



$$\$1,250.00 \div 30 \times 5 \text{ days} = \$208.33$$

Debit seller, credit buyer

Formula: loan amount  $\times$  interest rate  $\div$  12  $\div$  days in month of closing  $\times$  days owed = proration amount

2. For the proration of an assumed loan to be correct, it MUST be calculated using \_\_\_\_\_.
3. **Special rule: Prorated interest for a loan assumption is always annual interest divided by \_\_\_\_\_.**
4. Always DEBIT \_\_\_\_\_ and CREDIT \_\_\_\_\_.
5. The amount for any loan payment due will always be
- seller \_\_\_\_\_, and
  - broker \_\_\_\_\_ to pay the bill
6. \_\_\_\_\_ a loan payment due.

**C. Lender Reserves (Lines 19. Tax Reserve and 24. Hazard Insurance)**

1. Lender reserves for taxes and insurance to set up new impound accounts are *always* a \_\_\_\_\_ DEBIT.

**D. Notary Fees (Line 9)**

1. Notary fees are always paid by \_\_\_\_\_.
- The warranty deed is signed by the \_\_\_\_\_.
  - The cost of any associated notary fee is a DEBIT to the \_\_\_\_\_; CREDIT the broker.
  - A deed of trust is signed by the \_\_\_\_\_.
  - The cost of any associated notary fee is a DEBIT to the \_\_\_\_\_; CREDIT the broker.

**E. Insurance (Line 23. Premium for New Insurance)**

1. Hazard insurance is paid for a \_\_\_\_\_ that starts the month of closing.
2. Always DEBIT the buyer and CREDIT the broker in an assumed loan.

**F. Rental Properties (Line 33. Rents and Line 34. Security Deposits)**

1. Rent payments are collected on the \_\_\_\_\_ from the tenant.
2. The seller will always owe the buyer rent from closing to the end of the month.
  - a. Rent is always  
seller \_\_\_\_\_ prorated share, and  
buyer \_\_\_\_\_ prorated share.
3. A security deposit is the \_\_\_\_\_ money.
  - a. It must be transferred \_\_\_\_\_ to the buyer/new owner.
  - b. Always DEBIT the seller and CREDIT the buyer the \_\_\_\_\_.

**G. Prorating Rent**

1. Rent is income and not an expense, so it is handled differently than the proration rules about expenses paid in advance and arrears, which apply only to expenses paid in advance and arrears.
2. Rent is a revenue collected in advance by the seller from the tenant. This means the \_\_\_\_\_ will *always* owe the \_\_\_\_\_ for the buyer's portion of the month.

**FOR EXAMPLE**

Prorate monthly rent of \$3,000 for a closing on June 6.

**Formula:** Rent collected / days in month of closing × days owned = proration amount.  
Always debit seller, credit buyer.

**H. Seller-Carry Loans (Line 4. Deed of Trust, Payable to: Seller)**

1. When a seller agrees to lend the buyer part of the equity in the property, the closer/broker must handle the details of closing the seller-carry loan.
2. The amount of new seller-carry loan will always be these:
  - a. \_\_\_\_\_ to the seller because the seller will not receive this amount in money at closing. Instead, the seller agrees to accept the buyer's note and secure it with a deed of trust in this amount.
  - b. \_\_\_\_\_ to the buyer because the buyer does not bring this amount of money to closing. The buyer signs the note and secures the note with a deed of trust that creates a lien on the property (usually in second position to an existing loan).

3. The buyer will always owe interest for the month of closing on a seller-carry or new loan from the day of closing to the end of the month.

### I. Calculating Interest Adjustment on a Seller-Carry Loan or New Loan (Line 29. Interest on New Loan)

1. The seller has agreed to provide a second loan of \$10,000 at 9%. Calculate the interest adjustment for a closing on June 6 where the first payment is due on August 1. Remember the first payment in August will pay for the month of July (mortgage interest in arrears). We must collect interest for the portion of the closing month since it is not included in the amortization schedule.



$$10,000 \times 0.09 (9\%) \div 365 \times 25 \text{ days} = \$61.64 \text{ DEBIT buyer, CREDIT seller (lender)}$$

- a. For the calculation of a seller-carry to be correct, \_\_\_\_\_ interest must be calculated by dividing annual interest by \_\_\_\_\_.
  - (1) The buyer owes this interest to the lender, who is the seller.
  - (2) Always DEBIT the buyer. CREDIT the seller.
  - (3) **Tip:** Only interest on assumed loans is calculated by dividing annual interest by 12, then dividing by the days in the month.
- b. Annual interest on seller-carry or new loans is divided by \_\_\_\_\_.

### III. BUYER AND SELLER TRANSFERS

- A. Buyer and seller transfers occur when money is transferred on paper at closing between the two parties to the transaction (the buyer and the seller). Buyer and seller transfers don't involve the broker. Common buyer and seller transfers include the following:

1. Sales price: always \_\_\_\_\_ seller, \_\_\_\_\_ buyer
2. Loans in an assumption
  - a. The loan being \_\_\_\_\_
  - b. A \_\_\_\_\_ second loan
  - c. Always \_\_\_\_\_ seller, \_\_\_\_\_ buyer

## 3. Prorations

- a. \_\_\_\_\_ on a loan assumed: SOB (solve left side and divide annual interest by 12 and then by the days in the month of closing)
- b. \_\_\_\_\_ for the current year: SOB (solve left side)
- c. Water and/or sewer \_\_\_\_\_ bills—arrears or advance per the contract
- d. \_\_\_\_\_ on a new seller-carry loan: BOS (solve right side and divide annual interest by 365)
- e. \_\_\_\_\_: always seller owes buyer (**Remember:** Security deposits are not prorated but will be transferred in full.)
- f. HOA dues—arrears or advance per the contract

## 4. Calculation of interest on new loans

- a. \_\_\_\_\_ on a new seller-carry loan (divide annual interest by 365)

## IV. SELLER SETTLEMENT ITEMS

**A. Seller settlement items are CREDITS or DEBITS that will show on the \_\_\_\_\_ settlement statement and not on the \_\_\_\_\_ settlement statement.**

1. The majority of DEBITS have a corresponding CREDIT to the broker to pay the bill. **Remember:** All would show on the six-column Real Estate Settlement worksheet. (Items that may appear on both settlements have an\*.)

1.	Selling Price*	Seller _____
5.	Deed of Trust Payoff	Seller _____
6.	Interest on Loan Assumed—prorate what seller owes	Seller _____
7.	Owner's Title Insurance	Seller _____
8.	Closing Fee*	Seller _____
9.	Notary Fee*	Seller _____
13.	Recording: Release of Existing Deed of Trust	Seller _____
17.	Unpaid Taxes for the Preceding Year	Seller _____
18.	Taxes for Current Year—prorate what the seller owes*	Seller _____
34.	Security Deposit	Seller _____
36.	Loan Payment Due*	Seller _____
37.	Broker's Fee	Seller _____
38.	Seller's Attorney	Seller _____

## V. BUYER SETTLEMENT ITEMS

**A. Buyer settlement items are CREDITS or DEBITS that will show on the \_\_\_\_\_ settlement statement and not on the \_\_\_\_\_ settlement statement. (Items that may appear on both settlements have an \*.)**

1. The majority of DEBITS have a corresponding CREDIT to the broker to pay the bill. **Remember:** All would show on the six-column Real Estate Settlement Worksheet.

1.	Selling Price*	Buyer _____
2.	Earnest Money Deposits	Buyer _____
8.	Closing Fee*	Buyer _____
9.	Notary Fee*	Buyer _____
10.	Buyer's Attorney	Buyer _____
11.	Recording: Warranty Deed	Buyer _____
12.	Recording: Deed of Trust	Buyer _____
15.	Documentary Fee	Buyer _____
16.	Tax Certificate	Buyer _____
	Loan Costs	
7b.	Mortgagee's Title Insurance	Buyer _____
27.	Loan Origination Fee	Buyer _____
28.	Loan Discount Points	Buyer _____
29.	Interest on New Loan—prorate the amount owed for the month	Buyer _____
35.	Loan Transfer Fee	Buyer _____
30.	Survey	Buyer _____ unless otherwise negotiated in the contract
31.	Appraisal	Buyer _____ unless otherwise negotiated in the contract

2. Which buyer items are negotiable per the Contract to Buy and Sell?

- a. \_\_\_\_\_
- b. \_\_\_\_\_
- c. \_\_\_\_\_

**Remember:** ASC (ASK) if these have been negotiated in the CBS!

## VI. LOAN ASSUMPTION STATEMENT

**A. The lender provides a summary of the loan balance and other loan details to allow the broker to close the transaction.**

1. Always close to the lender's *exact* figures.
2. The assumption loan balance is a \_\_\_\_\_ to the seller and a \_\_\_\_\_ to the buyer.

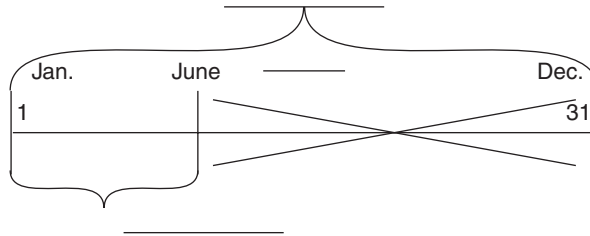
**B. The broker uses information from many sources, which may include the following:**

1. The \_\_\_\_\_
2. The Loan Assumption Statement for the existing loan
3. The Certificate of Taxes Due from the county
4. Bills and statements from service providers and utilities

**C. The six-column worksheet summarizes the financial transactions at the closing table and creates the information used to generate the \_\_\_\_\_ for the buyer and seller.****VII. PRORATION PRACTICE**

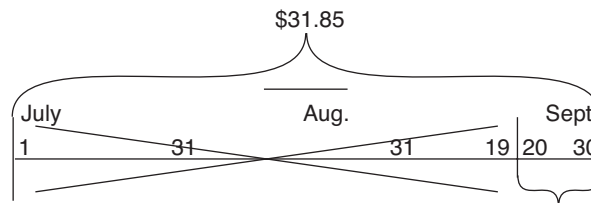
**Line 18. Current Year Taxes:** Taxes for the preceding year were \$2,970. For a June 6 closing, what will be the prorated share?

Jan.	31
Feb.	28
Mar.	31
Apr.	30
May	31
_____	_____
_____	_____



Total bill ÷ total days × days owned = prorated \$  
 \$ \_\_\_\_\_ ÷ 365 × \_\_\_\_\_ = \$ \_\_\_\_\_ debit \_\_\_\_\_ credit \_\_\_\_\_

**Line 32. Water and/or Sewer:** A water bill of \$31.85 was paid in advance for the months of July through September. If the closing is September 20, what will the prorated entry be?



Total bill ÷ total days × days owned = prorated \$  
 \$31.85 ÷ \_\_\_\_\_ × \_\_\_\_\_ days = \_\_\_\_\_ credit \_\_\_\_\_ debit \_\_\_\_\_

## SETTLEMENT EXERCISE 2: VA LOAN ASSUMPTION

To complete the six-column closing worksheet in this exercise, use the following information:

- The sellers have accepted an offer of \$300,000 with the closing on September 26.
- The buyers will provide \$1,500 for earnest money.
- The buyers will assume the seller's loan in the amount of \$250,000 (at 6% interest).
- The seller has agreed to provide a seller-carry of \$20,000 at 10% with the first payment due on November 1.
- The cost of the new title insurance is \$500.
- The buyer's attorney is charging \$135 to review the title.
- There are recording fees of \$6 for the warranty deed and \$21 for the new deed of trust.
- The notary fees are \$1 for the warranty deed and \$1 for the deed of trust.
- Don't forget to collect the documentary fee (\$0.01/\$100 of sales price).
- The \$15 tax certificate verified that there are no special taxes/assessments on the property and that last year's taxes are paid in full (\$1,400).
- The lender required the buyer to supply a credit report, which cost \$65.
- The buyer's new homeowners insurance policy, which starts the day of closing, is \$600.
- The water and sewer charge is a flat rate for September 1 through September 30. The bill for \$60 is due in advance and has *not* been paid.
- There is a loan transfer fee of \$100.
- The sellers have agreed to pay a 5% commission.
- The closing fee of \$160 will be split between the buyer and seller.

### Empire Savings Bank Statement for Assumption of Loan

*Figures effective through September 30, 2xxx.*

**The following must be paid before assumption can be completed:**

September 1 payment has been received	\$ 1,458.83
Loan transfer fee	\$ 100.00
<b>BALANCES:</b>	
With October 1 payment the interest due in arrears will be	\$ 1,250.00
Principal balance (after September 1 payment) at 6% interest	\$250,000.00

[illegible]



## DISCUSSION OF SETTLEMENT EXERCISE 2

This settlement is for assumption of a VA loan.

**Line 1. Selling Price and 2. Deposit, Paid to:** Complete these as in previous exercises.

**Line 3. Deed of Trust, Payable to:** Use the balance reported by the lender.

**Line 4. Deed of Trust, Payable to:** Seller financing assists the buyer and reduces the money the buyer brings to the closing table (debit the seller and credit the buyer). It also reduces the seller's sale proceeds at closing because the seller is allowing the buyer to borrow the seller's equity. They get a note for payment at a later time. Remember the settlement sheet is all about **money at closing**. The buyer will owe interest on this loan.

**Line 5. Deed of Trust, Payoff to:** There is no existing loan being paid off.

**Line 6. Interest on Loan Assumed:** The seller will owe the buyer interest for the portion of the month the seller lives in the property. **Remember:** Since the payment is in arrears, the seller will always owe the buyer this amount. In an assumption closing, an entry on line 6 is for this proration of the seller's interest owed to the day of closing. (Debit the seller and credit the buyer.)

When the lender provides only the loan balance and interest rate:

1. Calculate one month's interest as follows:

$$\text{loan balance} \times \text{annual interest rate} = \text{annual interest}$$

$$\text{annual interest} \div 12 = \text{one month's interest}$$



### FOR EXAMPLE

The loan is \$250,000 at 6% interest, and the closing is on September 26. The seller will owe 25 days.

One month's interest:

$$\$250,000 \times 0.06 (6\%) = \$15,000 \text{ annual interest}$$

$$\$15,000 \div 12 = \$1,250$$

Closing month's interest:

$$\$1,250 \div 30 \times 25 \text{ days the seller owes} = \$1,041.67$$

Debit the seller and credit the buyer for this amount. (**Remember:** The buyer will make the payment at the beginning of the next month. Interest is always paid in arrears.)

**Line 7. Title Insurance Premium:** The title insurance premium is charged to the seller, based on the Contract to Buy and Sell.

**Lines 8 through 14:** These are handled as discussed in Unit 1.

**Line 15. Documentary Fee:** A documentary fee is due whenever a warranty deed is recorded. Therefore, every closing on the state exam will have a documentary fee. This is the one entry that will always need to be made, whether the fee is mentioned or not.

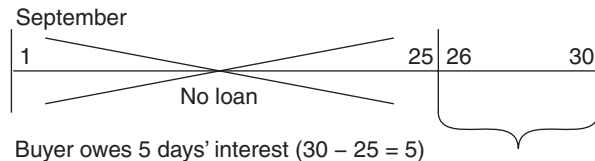
The documentary fee is one cent per \$100 of the purchase price.



**Line 29. Interest on New Loan:** An assumption closing may include a new seller-carry loan originated to assist the buyer with the purchase. In that case, check for the possibility of an interest adjustment for a few days at the beginning of the loan term. The broker must calculate this adjustment, since there is no institutional lender setting up the seller-carry loan.

New loan (including seller financing) interest adjustment is calculated on a **per diem** (daily) basis.

Annual interest ÷ 365  
= one day's interest  
× adjustment days  
= dollar adjustment



Total loan  $\$20,000 \times 0.10$  (10%) ÷ 365 × 5 = \$27.40  
Debit buyer, credit seller

If the first payment is more or less than one month after the closing date, an interest adjustment must be made. The first payment the buyer makes will be a full regular payment covering interest (in arrears) for a full month.

**Line 30. Credit Report:** The credit report is always a buyer payment. Debit the buyer and credit the broker.

**Line 32. Water/Sewer:** Water can be paid in arrears or in advance. In this case, it was due in advance for \$60; however, the seller has not paid the bill, which may become a lien. The seller will owe for a portion of the month that the seller owned the property (25 days). The buyer will owe for the five days of ownership after the closing. Debit the seller and buyer for their respective shares and credit the full amount to the broker to pay the bill.



Seller days 1 - 25 Buyer 30 - 25 (seller's last day) = 5 days

$\$60 \div 30 \times 25 = \$50$  debit seller;  $\$60 \div 30 \times 5 = \$10$  debit buyer; \$60 credit broker

**Line 36. Loan Payment Due:** In a loan assumption closing, the seller may not have made the payment due on the first day of the month of closing. This payment is entirely the seller's responsibility. It includes interest for the preceding month and a small payment to the principal that is reflected in the assumption balance reported by the lender.

Collect any payment due. The amount is never prorated and must be collected to satisfy the lender. The broker will send a check to the lender. Check the Loan Assumption Statement to determine if a payment is due. In this case it is not.

Never prorate a loan payment due. Debit the seller the entire amount.

**Below the Double Line:** Items below the double line on the closing worksheet are handled in the same way for all closings. Review the description in Unit 1 if you are unsure how to handle these items.

	SELLER				BUYER				BROKER			
	Debit		Credit		Debit		Credit		Debit		Credit	
1. Selling Price			300,000	00	300,000	00						
2. Deposit, Paid to:							1,500	00	1,500	00		
3. Deed of Trust, Payable to:	250,000	00					250,000	00				
4. Deed of Trust, Payable to:	20,000	00					20,000	00				
5. Deed of Trust, Payoff to:												
6. Interest on Loan Assumed	1,041	67					1,041	67				
7. Owner Title Insurance Premium	500	00									500	00
8. Closing Fee	80	00			80	00					160	00
9. Notary Fee	1	00			1	00					2	00
10. Title Exam by Buyer Attorney					135	00					135	00
11. Recording: Warranty Deed					6	00					6	00
12. Deed of Trust					21	00					21	00
13. Release												
14. Other												
15. Documentary Fee					30	00					30	00
16. Certificate of Taxes Due					15	00					15	00
17. Taxes for Preceding Year(s)												
18. Taxes for Current Year	1,027	95					1,027	95				
19. Tax Reserve												
20. Special Taxes/Assessments												
21. Personal Property Taxes												
22. Notary Fee Paid by Lender												
23. Premium for New Insurance					600	00					600	00
24. Hazard Ins. Reserve												
25. FHA Mortgage Ins. Assumed												
26. FHA Mortgage Ins. Reserve												
27. Loan Origination												
28. Loan Discount Points												
29. Interest on New Loan			27	40	27	40						
30. Survey												
Credit Report					65	00					65	00
31. Appraisal Fee												
32. Water and/or Sewer	50	00			10	00					60	00
33. Rents												
34. Security Deposits												
35. Loan Transfer Fee					100	00					100	00
36. Loan Payment Due												
37. Broker's Fee	15,000	00									15,000	00
38. Seller's Attorney												
Subtotals	287,700	62	300,027	40	301,090	40	273,569	62	1,500	00	16,694	00
Balance Due TO/From Seller	12,326	78									12,326	78
Balance Due TO/FROM Buyer							27,520	78	27,520	78		
TOTALS	300,027	40	300,027	40	301,090	40	301,090	40	29,020	78	29,020	78

### Homework Before Unit 3

1. Prorations and calculations practice on pages 298–299
2. Contract to Buy and Sell Exercise on page 303 (Use the Contract to Buy and Sell).
3. Settlement Exercise 3 on pages 304–305. Download the completed contract. You will use this to complete your Midterm Exam.
4. Midterm Exam
5. Read Unit 2 and complete Unit 2 glossary review.

### Balance Helper

1. If you cannot balance the columns, the problem is usually on the broker side. Subtract the lower amount from the larger, then divide by two and look for that or a close number in the six-column worksheet in the seller or buyer columns.
2. If the column does not balance, add from the bottom up to check figures before making changes.
3. The problem can also be something simple, like inputting figures incorrectly in your calculator. Always double-check your calculations.

## PRORATIONS AND CALCULATIONS PRACTICE

Practice these prorations before starting the midterm.

### Line 6: Interest on Loan Assumed

Closing date: October 25

The FHA loan balance after the October payment is \$125,000.

The interest rate is 10%.

Debit \_\_\_\_\_ Credit \_\_\_\_\_

Closing date: January 18

The VA loan balance after the January payment is \$98,675.67.

The interest rate is 7.75%.

Debit \_\_\_\_\_ Credit \_\_\_\_\_

### Line 18: Taxes for the Current Year

Closing date: February 16

Last year's taxes: \$1026.33

Debit \_\_\_\_\_ Credit \_\_\_\_\_

Closing date: August 13

Last year's taxes: \$963.60

Debit \_\_\_\_\_ Credit \_\_\_\_\_

### Line 29: Interest on New Loan

Closing date: October 25

The seller is carrying a second in the amount of \$15,000.

The interest rate is 10%.

The first payment is December 1.

Debit \_\_\_\_\_ Credit \_\_\_\_\_

Closing date: January 18

The seller is carrying a second in the amount of \$12,000.

The interest rate is 9.75%.

The first payment is March 1.

Debit \_\_\_\_\_ Credit \_\_\_\_\_

**Line 32: Water and/or Sewer**

Closing date: June 20

The bill was due April 1 and is unpaid. (The broker will collect and pay the bill.)

The water bill is for a three-month period beginning April 1.

Flat rate: \$95.55

Debit \_\_\_\_\_ Credit \_\_\_\_\_

Closing date: October 13

The water/sewer is paid in two months in arrears on December 1.

Flat rate: \$58.50

Debit \_\_\_\_\_ Credit \_\_\_\_\_

**Line 33. Rents**

Closing date: June 6

The total rent collected on June 1 is \$3,000.

Debit \_\_\_\_\_ Credit \_\_\_\_\_

HOA fees

Closing date: March 24

HOA fees are to be paid from March 1 to April 1.

Monthly HOA fees: \$275

Debit \_\_\_\_\_ Credit \_\_\_\_\_

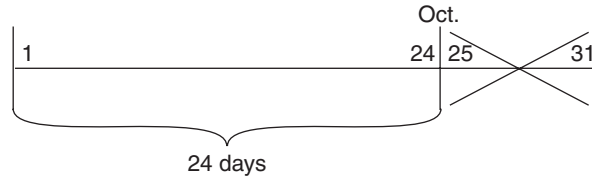
## SOLUTIONS FOR PRORATIONS AND CALCULATIONS PRACTICE

**Line 6. Interest on Loan Assumed**—SOB (solve left side)

Closing date: October 25

The FHA loan balance after the October payment is \$125,000.

The interest rate is 10%.

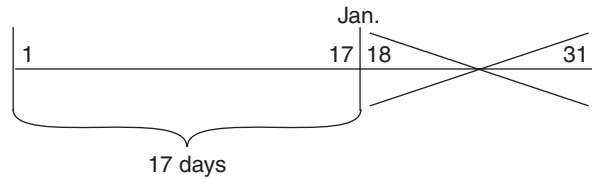


$\$125,000 \times 10\% \div 12 \text{ months} = \$1,041.67$  interest per month  
 $\$1,041.67 \div 31 \text{ days} \times 24 \text{ days} = \$806.45$  prorated share  
 Debit the seller and credit the buyer.

Closing date: January 18

The VA loan balance after the January payment is \$98,675.67.

The interest rate is 7.75%.

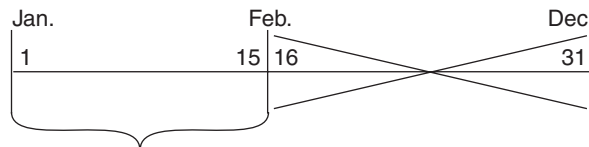


$\$98,675.57 \times 7.75\% \div 12 \text{ months} = \$637.28$  interest per month  
 $\$637.28 \div 31 \text{ days} \times 17 \text{ days} = \$349.48$  prorated share  
 Debit the seller and credit the buyer.

**Line 17. Taxes**—paid in arrears always SOB (solve left side)

Closing date: February 16

Last year's taxes: \$1026.33



Jan.	31
Feb.	15
	<hr/> 46

$\$1026.33 \div 365 \times 46 = \$129.35$   
 Debit seller, credit buyer



Jan.	31	
Feb.	28	$\$963.60 \div 365 \times 224 = \$591.36$
Mar.	31	Debit seller, credit buyer
Apr.	30	
May	31	
Jun.	30	
Jul.	31	
Aug.	<u>12</u>	
	224	

$$\text{\$12,000} \times 0.975 \text{ (9.75\%)} \div 365 \times 14 = \text{\$44.88} \quad \text{Debit buyer, credit seller}$$

### Line 32. Water and/or Sewer

Closing date: June 20

The water bill is for a 3-month period beginning April 1.

Flat rate: \$95.55 The bill was due April 1 and is unpaid.

April (30) + May (31) + June (30) = 91 days



$$\$95.55 \div 91 \times 80 = \$84$$

Debit seller \$84

$$\$95.55 \div 91 \times 11 = \$11.51$$

Debit Buyer \$11.55

Credit broker \$95.55

Because the bill is past due and unpaid, the broker must pay the bill.

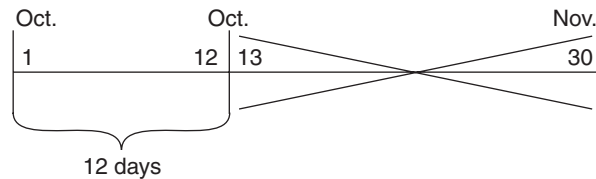
Charge each party their share of the bill and pay the entire amount to the utility company.

This is not a proration. It is an allocation.

Closing date: October 13

Water/sewer paid two months in **arrears** on December 1

Flat rate: \$58.50



$$\text{Oct. } \frac{12}{12}$$

$$\$58.50 \div 61 \times 12 = \$11.51$$

Debit seller, credit buyer

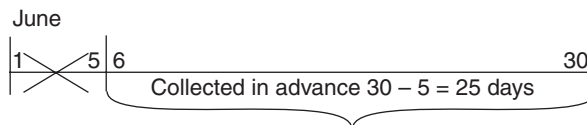
### Line 33. Rents—seller always owes buyer for month of closing

Closing date: June 6

The seller will owe the buyer for the majority of the month.

$$\$3,000 \div 30 \times 25 = 2,500$$

Debit the seller and credit the buyer.

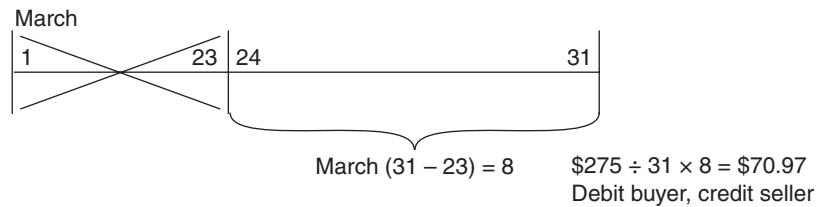


**HOA Fees**

Closing date: March 24

HOA fees are to be paid from March 1 to April 1.

Monthly HOA fees: \$275

**CONTRACT TO BUY AND SELL EXERCISE**

Use the Contract to Buy and Sell Real Estate in your contracts and forms supplement to answer the following questions. This will help prepare you for the midterm exam, which uses the same contract.

- What is the closing date?
- What are the amounts for?
  - Purchase price \_\_\_\_\_
  - Earnest money \_\_\_\_\_
  - Seller financing \_\_\_\_\_
- Would it be correct to use the assumption balance figure in Section 4 if you were creating a settlement sheet?  
Why or why not? \_\_\_\_\_
- What is the maximum amount the buyer has agreed to pay for the loan transfer fee?  
\_\_\_\_\_
- What is the interest rate on the seller-carry? \_\_\_\_\_
- If there is an appraisal, who has agreed to pay for it? \_\_\_\_\_
- How will closing costs be paid?
  - One-half by buyer and one-half by seller
  - By the buyer
  - By the seller

This is agreed in Section \_\_\_\_\_.
- How will taxes be prorated?  
This is agreed in Section \_\_\_\_\_.
- If the broker is to receive 5%, how much is the fee? \_\_\_\_\_  
How will it appear on the closing worksheet?  
Debit \_\_\_\_\_ Credit \_\_\_\_\_

## SOLUTIONS FOR CONTRACT TO BUY AND SELL EXERCISE

1. What is the closing date? June 6
2. What are the amounts for?
  - a. Purchase price \$300,000 (Section 4)
  - b. Earnest money \$6,000 (Section 4)
  - c. Seller financing \$10,000 (Section 4)
3. Would it be correct to use the assumption balance figure in Section 4 if you were creating a settlement sheet? No  
 Why or why not? The figure is just an estimate; the actual figure will be provided in the lender's assumption statement.
4. What is the maximum amount the buyer has agreed to pay for the loan transfer fee? \$1,200
5. What is the interest rate on the seller-carry? 9%
6. If there is an appraisal, who has agreed to pay for it? Seller
7. How will closing costs be paid?  
 One-half by buyer and one-half by seller  
 This is agreed in Section 15.
8. How will taxes be prorated?  
 Based on the taxes for the calendar year immediately preceding closing  
 This is agreed in Section 16.
9. If the broker is to receive 5%, how much is the fee? \$15,000  
 How will it appear on the closing worksheet?  
 Debit seller Credit broker

## SETTLEMENT EXERCISE 3

Using the following information and the lender's assumption statement, complete this closing created by the Contract to Buy and Sell. This information is needed to complete your midterm exam.

- The seller has agreed to sell a duplex for \$300,000. The closing date is June 6P.
- The earnest money deposit is \$6,000.
- The amount of the loan being assumed is listed in the assumption statement. The loan has an interest rate of 6%. (Don't forget to prorate interest if necessary.)
- The owner agrees to carry back a second of \$10,000 at 9% with monthly payments to begin August 1. (Don't forget to calculate interest if necessary.)
- Title insurance full coverage will be \$700 for standard and \$90 for extended.
- Closing fees are \$150 and will be charged per the contract.
- The fee for the seller's attorney is \$200 and the buyer's is \$175.
- Recording costs are \$20 for the warranty deed and \$24 for the second deed of trust.
- The tax certificate is \$15.
- Standard notary fees of \$1 per document will apply.

- Is there a documentary fee?
- The property taxes of \$2,970 for last year have not been paid.
- Is there a tax proration?
- The buyer is buying new hazard insurance for \$500 per year.
- The charge for the credit report is \$35.
- The buyer wants an appraisal, and the cost is \$350. Who, per the contract, is paying this fee?
- Each half of the duplex is rented for \$1,500 per month and has a \$1,000 security deposit.
- Make sure you check for any loan payments due or loan transfer fees.
- The broker will receive a 5% commission.

**Acme Savings and Loan Association Statement for Assumption of Loan**

*Figures effective through June 30, 2xxx.*

**The following charges must be paid before the assumption can be completed:**

June payment has not been received	\$2,640
Loan transfer fee	\$1,200
Total amount needed to assume loan	\$3,840

**Balances:**

With July 1 payment the interest due in arrears will be	\$1,250
Principal balance (after June payment) at 6% interest	\$250,000

To complete Exercise 4, use a worksheet from the back of the book. This exercise and the midterm also use the Contract to Buy and Sell. When you have finished, answer the questions on the midterm, which is an open book test.



# UNIT 3

## The New Loan Closing

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Discuss the impact of a new loan on broker entries.
- › Summarize the use of lender's net loan proceeds as a deposit to the escrow account to allow for the broker to pay any remaining bills and the final payout of amounts due to the seller.

### KEY TERMS

conventional loan	loan origination fee	realty tax service
first deed of trust	loan underwriting fee	release of deed of trust
flood plain certification	mortgagee title insurance	second deed of trust
loan discount points	policy	single entry

### OVERVIEW

#### Summarizing the Transaction

In a loan assumption closing, the broker prepares the entire closing and the six-column summary, which shows all of the funds transferred, received, and paid as part of the closing.

**Remember:** This work is often done by another closing entity, such as a title insurance company, but the broker remains responsible.

In a new loan closing, the lender will provide a statement of financial details and a list of bills the lender will pay from the gross loan proceeds. The broker will reconcile these lender adjustments and carry out the other contractual obligations as usual.

## Review of the Important Factors for a Loan Assumption Worksheet

In a loan assumption, the buyer is taking over responsibility for the existing loan balance on the property. In most cases, the lender must review the buyer's qualifications and approve, or disapprove, the loan assumption. Upon approval, the lender will provide the broker with a detailed Loan Assumption Statement to allow for the closing of the transaction and the assumption of the loan. The broker works with the lender to ensure the lender's requirements are met at closing.

**Important: Always close to the exact figures provided by the lender.**

The balance of the loan being assumed is a debit to the seller. This amount was not part of the seller's equity and the seller does not receive it at closing. The same loan balance is a credit to the buyer because the buyer does not need to bring that amount to closing. The buyer signs documents agreeing to take over payments on the loan balance.

- The broker gets information from several sources:
  - The Contract to Buy and Sell Real Estate
  - A Loan Assumption Statement from the lender for the existing loan
  - A certificate of taxes due from the county government
  - Other service providers, such as title insurance companies, attorneys, and utility companies
- The numbered lines of the closing worksheet are a checklist for most of the financial items from a closing. They summarize the debits and credits as described in Units 1 and 2.
- Each line used on the six-column worksheet for an assumption closing will have an equal dollar value of debits and credits.
  - Transfers between the buyer and seller, such as the selling price, prorations, or reserve account balance transfers, will have the same dollar amount entered for each party.
  - Bills for either party paid by the broker from the escrow account will be a debit to the party who owes the bill and a credit to the broker for the check written out of the escrow account.
- Work in an orderly fashion from top to bottom on the worksheet.
  - Completing one line at a time helps you keep track of where you are and helps prevent skipping important information.
  - When you reach the subtotal line on the closing worksheet, it will appear that the broker does not have sufficient money to pay the checks you have listed. That is true. When the summary is complete and the funds are shown coming from the buyer at the end, the broker will have enough money to disburse all of these amounts.
- The completed closing worksheet is a snapshot of all the financial matters that happen at the closing table. It represents the situation at the moment of closing after the buyer brings a check and the seller receives a check (in a normal closing).



## Important Factors for a New Loan Worksheet

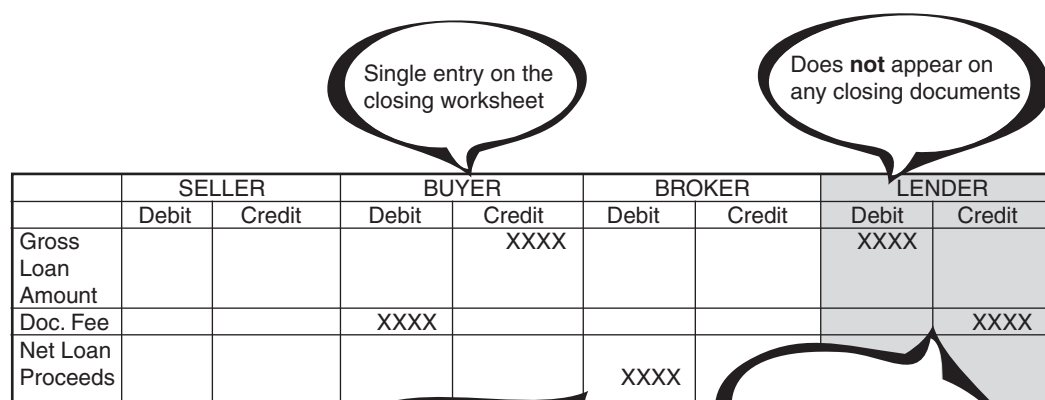
When the buyer is obtaining a new loan from a lending institution, the new loan amount and related loan costs become part of the closing. The broker must work with the new lender to ensure that all of the lender's requirements are met before closing the transaction. Always close to the lender's exact figures.

In a new loan closing the lender will pay, from the gross loan amount, some bills unique to the new loan closing, such as **loan origination fees** and **loan discount points**. In addition, the new lender may require the closing company to directly pay items that must be settled to ensure the lender's lien priority. Paying off the seller's current loan, recording a lien release for the seller's loan, and recording a deed of trust for the new loan would be examples of these items. All of these are paid from the gross loan amount before the lender provides the remaining money to the broker to complete the closing. This money will be a debit to the broker column and is called net loan proceeds.

The lender's New Loan Statement will show the gross loan amount approved for the buyer and list the various amounts paid by the lender from the loan. The buyer receives a credit for the full amount of the new loan. The closing worksheet and closing statement show a single entry for this credit.

When the new lender pays one of these bills of the seller or buyer, the broker does not need to write a check from the escrow account. Bills the lender paid must appear on the six-column closing worksheet as a debit to either the seller or the buyer. The lender doesn't necessarily know which items the parties agreed to pay; thus, the lender just lists them and the broker must allocate them to the appropriate party.

The lender's New Loan Statement is a bit like two invisible columns for the new lender. If we were to use an imaginary eight-column worksheet, the debit and credit columns for the lender would have a similar meaning as the debit and credit columns for the broker. When the lender pays something, there is a lender entry (in the invisible columns) and a debit to the seller or the buyer, but no broker entry. The six-column closing worksheet shows only the single entry charging the expense to the seller or buyer; it does not show charges to the lender.



	SELLER		BUYER		BROKER		LENDER	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Gross Loan Amount				XXXX			XXXX	
Doc. Fee			XXXX					XXXX
Net Loan Proceeds					XXXX			

Single entry on the closing worksheet

Does **not** appear on any closing documents

Gross loan amount minus lender charges will be the net loan proceeds to the broker

Lender credits are those bills the lender will pay with a check.

## Items Unique to a New Loan Closing

The following items are unique to a new loan closing:

- Dollar amounts imported from the lender's New Loan Statement will be single entries on the six-column worksheet.
- **Line 3. Deed of Trust Payable to:** This line shows the gross amount of the new loan. This is the amount the buyer is borrowing to contribute to the purchase. The amount is a credit to the buyer. This dollar amount does not impact either the seller or the broker—it is the first of the single entry items. Typically, this is the only entry from the new lender that will be a credit.
- **Line 5. Deed of Trust Payoff to:** This line shows loan payoff amounts owed by the seller. In the new loan closing, the amount to pay off this seller lien is included in the lender payout and is a single entry debit to the seller.
- Various expenses such as title insurance premiums, loan origination fees, and recording fees are listed on the lender's new loan statement and also become single entries allocated to the appropriate party for each expense based on the Contract to Buy and Sell.
  - An owner's title insurance policy is also a seller expense (by contract) and a seller debit.
  - Closing fees and the cost of the appraisal or a survey can be negotiated. The broker will debit these costs to party charged per the contract.
- As a general rule, costs directly associated with borrowing money will be charged to the buyer unless the contract specifically indicates that the seller has agreed to pay some or all of these costs.

## Title Insurance Premiums

**Line 7. Owner's Title Insurance:** The seller has agreed by contract to give evidence of merchantable title. This amount is a debit to the seller (as noted in Unit 1).

The owner's title insurance is a policy that will protect the new buyer from defects in title to real estate. It, in effect, protects a policyholder, the new buyer/owner, against loss from an occurrence that has already happened, such as a forged deed, somewhere in the chain of title. In addition, the title company also agrees to defend the policyholder's title in court against any lawsuits that may arise from defects found after the policy is issued.

- Always debit the seller.

**Line 7a. Extended Title Insurance:** Extended coverage eliminates or insures, over the standard exceptions of parties in possession, unrecorded easements, survey matters, unrecorded mechanic's liens, the gap period (from the effective date of the commitment to the date the deed is recorded) unpaid taxes, and assessments. The fee for this coverage is small, usually \$75 to \$100, and payment is negotiated in the contract.

- Debit the buyer or seller as negotiated.

**Line 7b. Mortgagee's (Lender's) Title Insurance:** The new lender normally requires **mortgagee title insurance**; therefore, it is the responsibility of the borrower to pay the premium.

The mortgagee's policy protects the lender against the same defects as an owner under an owner's policy, but the insurer's liability is limited to the mortgage balance as of the date of the claim. Because of the reduced liability, and if the policy is ordered from the same company as the owner's policy, it usually costs less than the owner's policy.

Almost all major lenders now require, in addition to the mortgagee's policy, extra protection called a Form 100 endorsement. This form protects the lender against loss incurred due to any errors in the covenants, conditions, or restrictions, as well as loss due to any encroachments. In addition to the Form 100 endorsement, the lender may require other endorsements to cover other title concerns.

- Always debit the buyer.

**Line 13. Release of Deed of Trust:** The seller pays to record the release of the previous deed of trust. Recording the release clears the lien from the property as the seller promised, and it will allow the new lender's loan to be in first position.

- Always debit the seller.

**Line 27. Loan Origination Fee:** This is the lender's fee for making the loan. Think of it as the lender's commission. It is typically expressed as a percentage of the loan amount (e.g., 1% origination fee).

- Debit the buyer.

**Line 28. Discount Points/Loan Discount Fee:** The sales contract states that the buyer will pay this fee, so it is a debit to the buyer. The buyer can request that the seller pay this fee in the additional provisions section of the Contract to Buy and Sell. The broker should always review the contract to determine who will be responsible for this charge. Discount points are expressed as a percentage of the loan amount (3 points = 3% of the loan amount). In some instances, the seller in the sales contract may agree to pay for some or all of the discount points. The closer/broker must read the contract to determine who to charge.

- Debit the buyer, unless otherwise stated in the contract.

**Line 31. Appraisal Fee:** When an appraisal fee is involved in closing a transaction, it is typically charged to the buyer, since it is a requirement of obtaining the loan. In some instances, the seller in the sales contract may agree to pay for the appraisal. The closer/broker must review the contract to determine whom to charge.

- Debit the buyer or seller as negotiated.

**Lines 19 & 24. Lender Reserves:** For a new loan, the lender will collect funds from the closing to open the account with a starting balance. This amount plus the monthly installments (part of PITI) will be sufficient to pay the taxes when they become due.

- Always debit the buyer.

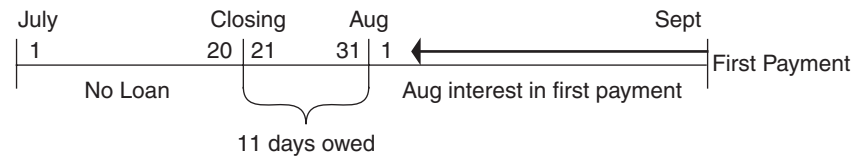
**Line 29. Interest on New or a Seller-Carry Loan:** Lenders insist that every payment on a fully amortized loan must be the same amount. Lenders do not permit the first payment to be changed for part of a month.



#### FOR EXAMPLE

If there is a closing on July 21 and the buyer's first payment will not be due until September 1, the lender requires that the interest be paid at closing from the day of closing to August 1. This is because the interest is payable in arrears. When the buyer makes the September payment, it will include the payment of interest for the entire month of August. This is also true for seller-carry loans.

- Always debit the buyer (for the gap between the closing date and the end of the month).



In a new institutional loan situation, the lender will calculate this adjustment for you. In most cases, it will result in a debit to the buyer.

### Net Loan Proceeds From a New Loan

After the lender has paid or withheld the items listed on the New Loan Statement, the lender prepares a check to the closing company (broker) for the net loan proceeds. The lender must also provide good funds, often by wire transfer. This is simply the gross loan amount minus all of the items the lender deducts. The check for the net loan proceeds is delivered to the broker and deposited into the broker column (single entry broker debit). This amount, along with cash brought by the buyer, allows the broker to write the remainder of the checks to close the transaction. Traditionally, the net loan proceeds figure is entered on the last line above the subtotals.

For a new loan closing, start the six-column closing worksheet with the New Loan Statement amounts. **Remember:** All items related to the new loan are single entries.

- On line 3, enter the gross amount of the new loan—a buyer credit.
- Continue with the various lender fees and disbursements—a number of single entry debits allocated to the seller or buyer depending on who owns the bill.
- The final new loan entry, on line 39, is the net loan proceeds—a debit to the broker for deposit into the escrow account.
- Taken together, these entries will result in a balanced closing worksheet with the total credits equaling the combined debits. The dollar values are balanced down the column, but are not balanced on each line (across the sheet) as you saw in the loan assumption.



#### FOR EXAMPLE

Line 3. Gross loan amount	\$86,800.00
Minus total lender payouts	<u>− \$30,616.14</u>
Line 39. Net loan proceeds to broker	\$56,186.86

The broker is still responsible for accounting for all of the remaining closing items, just as in the loan assumption closing. From the selling price on down, the broker must take care of the debits and credits for the closing. These remaining entries (not specific to new loans) will all be balanced lines with equal dollar values of debits and credits.

## New Loan Items Handled by the Lender and Not by the Broker

The following points will be helpful when dealing with new loan items handled by the lender:

- The gross amount of the new loan is a credit to the buyer (single entry).
- Recording the new deed of trust and payment of loan origination fees are good examples of lender payouts.
- There is no broker entry for these items and no offsetting credit, just the debit to the responsible party.
- The new lender actually pays these items and provides a detailed list to the broker or closing company. As usual, close to the lender's exact figures.

Settlement Exercise 4 will show a typical new loan closing in detail.

## New Loans and Net Proceeds

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price		110,000 00	110,000 00			
2. Deposit, Paid to: <b>Western Realty</b>				5,000 00	5,000 00	
3. Deed of Trust, Payable to: <b>new 1<sup>st</sup></b>				86,800 00		
4. Deed of Trust, Payable to: <b>new 2<sup>nd</sup></b>						
5. Deed of Trust, Payoff to: <b>old lender</b>	26,740 72					
6. Interest on Loan Assumed						
7. Title Insurance Premium	750 00		100 00			
a. Extended Title Insurance						
b. Mortgagee's Policy						
8. Closing Fee	75 00		75 00			150 00
9. Notary Fee	1 00					1 00
10. Title Exam by: <b>Buyer's Attorney</b>						
11. Recording: Warranty Deed			6 00			
12. Deed of Trust <b>new 1<sup>st</sup> TD</b>			31 00			
13. Release <b>old 1<sup>st</sup> TD</b>	16 00					
14. Other <b>2<sup>nd</sup> TD</b>						
15. Documentary Fee			11 00			
16. Certificate of Taxes Due			15 00			15 00
17. Taxes for Preceding Year(s) <b>pd. \$1,051.20</b>						
18. Taxes of Current Year				561 60		
19. Tax Reserve			438 00			
21. Notary Fee <b>paid by Lender</b>			1 00			
22. Hazard Ins. Premium Assumed			654 00			
23. Premium for New Insurance			109 00			
24. Hazard Ins Reserve						
25. Mortgage Ins. Assumed						
26. Mortgage Ins. Reserve						
27. Loan Service Fee			868 00			
28. Loan Discount Fee						
29. Interest on New Loan			323 00			
30. Survey			100 00			
Credit Report			65 00			
31. Appraisal Fee			400 00			
32. Water and/or Sewer		14 40	14 40			
33. Rents						
34. Security Deposit						
35. Loan Transfer Fee						
36. Loan Payment Due						
37. Broker's Fee	5,500 00					5,500 00
38. Seller's Attorney						
39. Net Loan Proceeds					56,186 86	
Subtotals	33,644 32	110,014 40	113,210 82	92,361 60	61,186 86	5,666 00
Balance Due To/From Seller:	76,370 08					76,370 08
Balance Due To/From Buyer:				20,849 22	20,849 22	
TOTAL	110,014 40	110,014 40	113,210 82	113,210 82	82,036 08	82,036 08

Seller is owed a check at closing

Buyer is bringing money to closing

$\$86,800 - \$30,613.14 = \$56,186.86$   
 Net loan proceeds  
 New loan - total payouts = net loan proceeds

New loan amount  
Always a credit to the buyer

Single entry items  
Lender payouts

New loan amount minus  
total payouts = net loan  
proceeds. Broker must have  
this amount to complete the  
closing.

## Other Forms Used at Closing

The closing statement is the two-column summary sheet. If the broker prepares the closing, this form or an equivalent is mandatory. One closing statement is prepared for the seller, and another is prepared for the buyer. These forms are checked and signed by the designated broker working with each party.

A closing worksheet for real estate settlement is provided by the Real Estate Commission as a convenience to brokers. This is the six-column closing worksheet you used in Exercises 1 through 4. This sheet summarizes the debits and credits for both the seller and buyer and is the only sheet that includes the broker escrow account debits and credits. This summary may be completed with a computerized spreadsheet if desired. A balanced closing worksheet is the best way to ensure complete and accurate Statements of Settlement for the parties.

The Real Property Transfer Declaration (TD-1000) is another responsibility of the closing company. It is a report to the county assessor describing a transaction.

The purpose of the TD-1000 is to “provide essential information to the county assessor to help ensure fair and uniform assessments for all property for property tax purposes.”

## Recordkeeping

Employing brokers and independent brokers must keep transaction records, including the closing documentation, for four years to comply with Real Estate Commission rules.

## Good Funds at Closing

**Remember:** All money brought to closing by any party must comply with the banking rules that define *good funds* as follows:

- Cashier’s check or certified check from a recognized commercial bank
- Teller’s check from a thrift institution such as a savings and loan or credit union
- Wire transfer via the Federal Reserve System

The seller may specify in the closing instructions want of good funds at closing as well. Normally, money coming out of the closing will be in the form of a wire transfer or a business check from the broker or closing company.

**Note:** The Contract to Buy and Sell does not recognize cash as good funds, and most closing companies will not accept cash at the closing table. Buyers and sellers are expected to bring good funds as described earlier to closing.

## Error at Closing

A broker that discovers any error before closing should have the error corrected. A relatively minor error discovered at closing can be adjusted between the parties, if they agree, using a personal check or cash to settle. A memorandum of this adjustment, signed by both parties, should be made and copies given to all parties. A major error is best handled by having the error corrected. The closing can be delayed, with agreement of all parties, until the figures can be corrected.

## Additional Reporting Requirements: Nonresident Seller Withholding

### State law

When a seller is not a resident of Colorado, state law requires the closing entity to withhold potential income tax for sales in excess of \$100,000. The withholding is 2% of the sales price or the entire net proceeds (balance due to the seller) of the sale, whichever is less.

### Exceptions

There are a number of exceptions when the withholding law does not apply, most notably if the property was the seller's principal residence.



#### FOR EXAMPLE

Assume the nonresident seller withholding does apply. The seller will receive \$123,000 at closing (without the withholding), and the selling price is \$435,000. The closing entity must withhold 2% of the selling price (\$8,700) from the seller's proceeds of sale.

The closing company will complete a report for the Colorado Department of Revenue and immediately forward the report and the money to the Department of Revenue. If the seller believes a refund is due, the seller files a state income tax return and requests a refund.



#### FOR EXAMPLE

Presume the same scenario as earlier. The withholding law still applies. This time, the seller is due to receive \$7,000 net proceeds at closing, but the seller owes \$8,700. The closing entity will withhold only \$7,000. The seller is never required to bring additional money to closing to make up the full 2% withholding.

## SUMMARY

The six-column settlement closing worksheet summarizes the financial aspects of a closing for the seller, the buyer, and the broker.

In a loan assumption closing, debits and credits will be equal on each line of the six-column settlement worksheet.

Close assumptions to the exact lender figures, always using double entry.

Lenders for new loan closings often pay some charges to protect their own interests.

On the settlement worksheet, the buyer receives a single entry credit for the gross new loan amount. Items paid by the lender are a single debit charge to one of the parties on the six-column worksheet. All items related to the new loan are single entry. Close new loans to the exact lender figures.

## UNIT 3: GLOSSARY REVIEW

Match the terms with the definitions.

conventional loan	mortgagee's title insurance policy
designated broker	private mortgage insurance (PMI)
first deed of trust	release of deed of trust
loan discount points	second deed of trust
loan origination fee	single entry

1. The document recorded to indicate that a lien has been paid off is a \_\_\_\_\_.
2. A document that creates a lien and has the highest priority is a \_\_\_\_\_.
3. The administrative fee charged by a lender to set up a loan is the \_\_\_\_\_.
4. To protect against defects in title, a lender will usually require the buyer to purchase a \_\_\_\_\_.
5. Fees usually quoted as a percentage of the loan amount and used to increase the lender's yield, and/or acquire a lower interest rate for the buyer, are known as \_\_\_\_\_.
6. A loan that is neither guaranteed nor insured by a government agency is called a \_\_\_\_\_.
7. A loan created with a lower lien priority, such as a seller-carry loan, is often a \_\_\_\_\_.
8. A conventional loan with a loan-to-value ratio greater than 80% will typically require \_\_\_\_\_.
9. An assumption close uses double entries, while a new loan close is mostly \_\_\_\_\_.
10. The \_\_\_\_\_ is responsible for the settlement statement for the party represented.



## LECTURE OUTLINE

### New Loans: The Big Picture

- In Unit 1, the listing brokerage firm used its trust account to close a cash real estate transaction between the seller and the buyer.
- In Unit 2, the buyer paid for the real estate by assuming the seller's existing senior loan, obtaining a new junior loan from the seller, and paying the balance due from the buyer in good funds.
- In a real estate transaction that involves a new loan from a third-party lender, the broker still uses its trust account to close the real estate transaction, but the lender uses the lender's trust account to close the new loan transaction.
- The items related to the closing of the new loan transaction will show up as single-entry items on the six-column Real Estate Settlement Worksheet.
- The other entry would show up as a single-entry item on the lender's worksheet if we could see it.

## I. REVIEW OF THE SIX-COLUMN REAL ESTATE SETTLEMENT WORKSHEET

### A. Types of closing entries

There are four main types of entries on the settlement worksheet:

1. Seller and buyer exchanges of funds
  - a. Examples are prorations and the \_\_\_\_\_.
  - b. Each line has equal dollar values of DEBITS and CREDITS.
2. Funds held by the broker until the closing
  - a. The most common example is \_\_\_\_\_.
  - b. This is a CREDIT to the buyer and \_\_\_\_\_ to the broker (deposit into escrow account), offsetting DEBIT and CREDITS.
3. Bills paid by the broker on behalf of the seller or buyer
  - a. Examples: attorney's fee or \_\_\_\_\_ fees
  - b. DEBIT to the responsible party for the item, and \_\_\_\_\_ to the broker (out of the escrow account) for writing the check

4. New loan items handled by the lender, not by the broker
  - a. New loan gross amount
  - b. Lender payouts of many fees, including loan origination fees or recording the new deed of trust
  - c. No broker entry for these items and no offsetting CREDIT, only the DEBIT to the responsible party
  - d. Broker's net loan proceeds, DEBIT into the broker's column
  - e. Broker deposit—new loan single entry
  - f. The new lender has the closing company pay these items and provides a detailed list to the broker. Close using the lender's exact figures.

## II. THE SIX-COLUMN CLOSING WORKSHEET—SUMMARIZING THE TRANSACTION

### A. The six-column closing worksheet summarizes the transaction with DEBIT and CREDIT columns for the following parties:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

### B. Items unique to the six-column worksheet

1. An optional form that may be done on a computer spreadsheet or other methods if desired.
2. Only the six-column Real Estate Settlement Worksheet shows items going in and out of \_\_\_\_\_.
3. A properly balanced settlement six-column Real Estate Settlement Worksheet provides the information for the settlement statement for the buyer and seller.

### C. \_\_\_\_\_

1. Buyer assumes and agrees to pay the remaining balance on a seller's existing loan (uses double entries).

**D.**

1. When the buyer gets a new loan, the new lender will withhold funds from the gross loan amount to pay some of the expenses of closing (uses mostly single entries).

	SELLER		BUYER		BROKER		LENDER	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Gross Loan Amount				XXXX			XXXX	
Doc. Fee			XXXX					XXXX
Net Loan Proceeds					XXXX			

Single entry on the closing worksheet

Does **not** appear on any closing documents

New loan amount minus ledger charges will be the net loan proceeds the broker will need to write the seller's check.

Lender charges are those that the lender will pay.

**III. OTHER FORMS USED AT CLOSING****A. Seller or buyer settlement statement**

1. This form was reviewed in Closings, Units 1 and 2.
2. This form or a suitable substitute is \_\_\_\_\_ when the broker conducts the closing.
3. It shows all of the DEBITS and CREDITS for the \_\_\_\_\_ or \_\_\_\_\_.
4. It must be maintained in employing broker's files for \_\_\_\_\_.
5. The \_\_\_\_\_ broker checks figures for the seller.
6. The \_\_\_\_\_ broker checks figures for the buyer.

**B. Real Property Transfer Declaration (TD-1000)**

1. Helps ensure fair and uniform \_\_\_\_\_ of property taxes
2. Should be completed at closing

**IV. GOOD FUNDS AT CLOSING****A. Good funds are**

1. a \_\_\_\_\_ or a \_\_\_\_\_  
\_\_\_\_\_ from a commercial bank,
2. a \_\_\_\_\_ from a savings and loan, or
3. a \_\_\_\_\_.

**B. A personal check or company business check is not classified as good funds.****C. Promissory note for earnest money**

1. Must be honored in time to clear and be \_\_\_\_\_ by closing

**V. ERRORS AT CLOSING****A. Found before closing**

1. Have the \_\_\_\_\_ correct the error.

**B. Minor error found at closing**

1. Parties may agree to \_\_\_\_\_ (typically with a personal check or cash) or \_\_\_\_\_ closing.

**C. Lender's figures (new or existing loan)**

1. Close to lender's exact figures
2. Lender will adjust with appropriate party after closing.

**VI. NONRESIDENT SELLER WITHHOLDING****A. Colorado law calls for a possible withholding of potential income tax from the gain in the sale of a property sold by a non-Colorado resident.****B. The seller is subject to withholding tax if**

1. the seller lives outside of \_\_\_\_\_; and
2. the sales price is greater than \_\_\_\_\_.

**C. There are several exemptions from this requirement, including**

1. the sale of a principal residence.

**D. The amount of tax withheld will be the lower of**

1. \_\_\_\_\_% of the sales price; or
2. the seller's entire net proceeds (balance due to the seller).

**E. It is the responsibility of the \_\_\_\_\_ to collect the withholding tax:**

1. The closing entity \_\_\_\_\_, or the closing/title company.
2. The closing entity is responsible for immediately forwarding the funds to the Colorado \_\_\_\_\_.

**VII. NEW LOAN CLOSINGS AND THE NEW LOAN STATEMENT****A. A New Loan Statement provides the broker the following information:**

1. The amount of the loan
2. Specific bills the lender will withhold from the loan
3. Net amount of the check the lender will provide to fund the rest of the closing

**B. Use lender figures \_\_\_\_\_ as provided.****C. In a new loan, the lender brings the majority of the money for the buyer:**

1. The New Loan Statement will show three sets of numbers the closer/broker needs:
  - a. Gross or total new loan amount
  - b. \_\_\_\_\_
  - c. \_\_\_\_\_
2. Buyer will always have a large \_\_\_\_\_ called the *gross loan amount*.
3. From this amount, the lender will pay the majority of the bills, which are then totaled in lender payouts.
4. The difference between the gross loan amount and the lender payouts is the \_\_\_\_\_, which will be a \_\_\_\_\_ (deposit) into the closer/broker column so the final checks can be written.

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price		110,000 00	110,000 00			
2. Deposit, Paid to: <b>Western Realty</b>				5,000 00	5,000 00	
3. Deed of Trust, Payable to: <b>new 1<sup>st</sup></b>				86,800 00		
4. Deed of Trust, Payable to: <b>new 2<sup>nd</sup></b>						
5. Deed of Trust, Payoff to: <b>old lender</b>	26,740 72					
6. Interest on Loan Assumed						
7. Title Insurance Premium	750 00		100 00			
a. Extended Title Insurance						
b. Mortgagee's Policy						
8. Closing Fee	75 00		75 00			150 00
9. Notary Fee	1 00					1 00
10. Title Exam by: <b>Buyer's Attorney</b>						
11. Recording: Warranty Deed			6 00			
12. Deed of Trust <b>new 1<sup>st</sup> TD</b>			31 00			
13. Release <b>old 1<sup>st</sup> TD</b>	16 00					
14. Other <b>2<sup>nd</sup> TD</b>						
15. Documentary Fee			11 00			
16. Certificate of Taxes Due			15 00			15 00
17. Taxes for Preceding Year(s) <b>pd. \$1,051.20</b>						
18. Taxes of Current Year				561 60		
19. Tax Reserve			438 00			
21. Notary Fee <b>paid by Lender</b>			1 00			
22. Hazard Ins. Premium Assumed						
23. Premium for New Insurance			654 00			
24. Hazard Ins Reserve			109 00			
25. Mortgage Ins. Assumed						
26. Mortgage Ins. Reserve						
27. Loan Service Fee			868 00			
28. Loan Discount Fee						
29. Interest on New Loan			323 00			
30. Survey			100 00			
Credit Report			65 00			
31. Appraisal Fee			400 00			
32. Water and/or Sewer		14 40	14 40			
33. Rents						
34. Security Deposit						
35. Loan Transfer Fee						
36. Loan Payment Due						
37. Broker's Fee	5,500 00					5,500 00
38. Seller's Attorney						
39. Net Loan Proceeds					56,186 86	
Subtotals	33,644 32	110,014 40	113,210 82	92,361 60	61,186 86	5,666 00
Balance Due To/From Seller	76,370 08					76,370 08
Balance Due To/From Buyer			20,849 22		20,849 22	
TOTAL	110,014 40	110,014 40	113,210 82	113,210 82	82,036 08	82,036 08

New loan amount  
Always a credit to the buyer

Single entry items  
Lender payouts

New loan amount minus  
total payouts = net loan  
proceeds. Broker must have  
this amount to complete the  
closing.

Seller is owed a  
check at closing

Buyer is bringing  
money to closing

$\$86,800 - \$30,613.14 = \$56,186.86$   
Net loan proceeds  
New loan - total payouts = net loan proceeds

- The new lender provides a New Loan Statement with information about financing and items the lender is paying from the gross loan amount.
- The lender also provides a \_\_\_\_\_ number that represents what remains of the gross loan amount after the lender pays the bills listed in the new loan statement.
- All of these numbers from the new loan statement are single \_\_\_\_\_ on the six-column settlement worksheet.

	SELLER		BUYER		BROKER		LENDER	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Gross Loan Amount				XXXX			XXXX	
Doc. Fee			XXXX					XXXX
Net Loan Proceeds					XXXX			

Single entry on the closing worksheet

Does **not** appear on any closing documents

New loan amount minus ledger charges will be the net loan proceeds the broker will need to write the seller's check.

Lender charges are those that the lender will pay.



### FOR EXAMPLE

Line 3. Gross loan amount	\$86,800.00
Minus total lender payouts	<u>— \$30,613.14</u>
Line 39. Net loan proceeds to broker	\$56,186.86

8. The broker records the lender single entry numbers on the closing worksheet \_\_\_\_\_.
9. The closing entries not related to the new loan are all double entries and result in \_\_\_\_\_ with equal dollar values of DEBITS and CREDITS.

### D. Items unique to a new loan closing

1. The gross amount of the new loan on line 3 is a buyer \_\_\_\_\_ single entry.
2. A loan payoff on line 5 to clear the seller's previous loan is a \_\_\_\_\_ DEBIT single entry.
3. Various expenses paid by the lender on behalf of both the seller and the buyer are single entry \_\_\_\_\_ to the party responsible for that obligation.
4. The net loan proceeds from the lender's New Loan Statement is a single entry DEBIT to the \_\_\_\_\_. It is deposited into the escrow account and used to fund the closing.

**E. Items unique to the New Loan Statement**

Items will be assigned as follows on a new loan statement:

Line	Item	To the Buyer	When
3	New loan amount		Always
7a.	Mortgagee policy		Always
31	Appraisal		Unless otherwise stated in the contract
27	Loan origination fee		Unless otherwise stated in the contract
28	Discount points		Unless otherwise stated in the contract
29	Interest on new loan		If first payment more than one month after closing
	<b>Item</b>	<b>To the Seller</b>	<b>When</b>
5	Prior loan payoff		Always
13	Release of deed of trust		Always



## EXERCISE

### Settlement Exercise 4: New Conventional Loan

#### Broker Details—Double Entries

Closing date: July 15

Sale price..... \$110,000

Deposit ..... \$5,000

Tax certificate ordered and paid for by broker is \$15

Shows taxes for previous year are \$1,051.20 and are paid

Notary fee for the warranty deed is \$1

Water and sewer, paid quarterly in advance from June 1 through August 31, is \$27.60

Closing fees of \$150, split 50/50

Commission is 5%

#### NEW LOAN STATEMENT—Single Entries

New loan at 8% interest..... \$86,800.00

Payoff of present loan of \$26,625.52, including interest on present loan:

10 days at \$11.52 per day; includes delivery time ..... 26,740.72

Title policy (owners) ..... 750.00

Mortgagee policy ..... 100.00

Recording warranty deed ..... 6.00

Recording deed of trust..... 31.00

Release of deed of trust ..... 16.00

Documentary fee..... 11.00

New reserve for taxes (5 months: April through August) ..... 438.00

Insurance premium..... 654.00

New insurance reserve (2 months) ..... 109.00

Loan fee: 1% ..... 868.00

Interest to August 1 (first payment due September 1; interest in arrears)..... 323.42

Survey..... 100.00

Credit report..... 65.00

Lender notary fee ..... 1.00

Appraisal fee..... 400.00

Total amount of lender payouts..... \$30,613.14

NET LOAN PROCEEDS..... \$56,186.86

Enter all of the new lender details as single entries before you enter the broker details.

## Settlement Exercise 4

[illegible]

## New Loan Details

All of these are single entries (broker entries will be covered after this section).

**3. Trust Deed payable to: new lender.** The new loan amount is a credit to the buyer, since it will be applied to the purchase price of the property. This item is a single entry since it appears on the lender's New Loan Statement and reduces the check the buyer must bring to the closing. It has no effect on either the seller or the broker. It may help to think the single entries are being accounted for on the lender's credit column, which can't be seen. These columns hold the offsetting entries for every item, which will be a single entry on our new loan closing.

New loan at 8% interest .....\$86,800.00

Credit buyer (single entry)

**5. Trust deed payoff.** The payoff on the existing loan is a debit to the seller because it is the seller's obligation to clear the existing lien from the property. To determine the amount of the payoff, the broker must request a payoff statement from the seller's loan company. This statement shows the balance after adjustments for interest, penalties, and any credits the seller may have in the way of tax or insurance reserves.

**Note:** The broker must always close to the figures provided by the new lender. If the broker disagrees with the lender's figures, the dispute must be settled with the lender ahead of time, or the disputed numbers are used to close and adjustment is sought after closing.

Payoff of present loan of \$26,625.52, including interest on present loan:

10 days at \$11.52 per day, including delivery time .....\$26,740.72

Debit seller (single entry)

**7. Title insurance premiums.** The seller has agreed by contract to give evidence of merchantable title.

Title policy (owners) .....\$750.00

Debit seller (single entry)

The new lender normally requires mortgagee's title insurance. It is the responsibility of the borrower to pay the premium.

**7a. Mortgagee policy** .....\$100.00

Debit buyer (single entry)

**11. and 12. Recording warranty deed and trust deed.** It is the obligation of the buyer to pay for recording the new warranty deed and trust deed. These items are usually single entries since the new lender will pay them.

Recording warranty deed.....\$6.00

Recording deed of trust .....\$31.00

**13. Release.** The seller pays to record the release of the deed of trust. Recording the release clears the lien from the property.

Debit seller (single entry)

Release of deed of trust.....\$16.00

**Line 15: Documentary fee.** Debit buyer (single entry)

Documentary fee.....\$11.00

**17. Taxes for preceding year(s).** If the tax certificate shows that the taxes for the preceding year have been paid, no entry is required. If taxes are owed, the lender will pay them. Debit the seller (single entry).

**19. Tax reserve.** After the closing, the lender will collect one month's taxes in each monthly installment. However, the lender will collect funds from the closing to prime the account. This amount plus the monthly escrow installments will be sufficient to pay the taxes when they become due. In this example, the lender is requesting five months' reserve (April through August) since the buyer will not make the first monthly payment until September 1. Most lenders escrow from April to April since they must pay the property taxes by April 30 each year.

New reserve for taxes (five months—April to August).....\$438.00

**21. Lender notary.** This is the notary charge for witnessing the buyer signing the deed of trust.

**23. Premium for new insurance.** The lender requires a one-year hazard insurance policy to be purchased, effective the day of closing. Since the policy is for the benefit of the buyer, the cost is a debit to the buyer (single entry).

Insurance premium .....\$654.00

**24. Hazard insurance reserve.** As with the tax reserve, the lender requires an amount up front to prime the escrow account, usually a minimum of two months. Debit the buyer.

New insurance reserve (two months) .....\$109.00

**27. Loan origination fee.** This is the lender's fee for making the loan. Debit the buyer (single entry).

Loan fee 1%.....\$868.00

**29. Interest on a new loan.** Since the buyer's first payment will not be due until September 1, the lender requires that the interest be paid from the day of closing to August 1. Interest is payable in arrears. When the buyer makes the September payment, it includes the payment of interest for the entire month of August. At closing, the buyer must pay the interest adjustment beginning July 15 and ending July 31. Debit the buyer (single entry).

Interest to August.....\$323.42

(The first payment is due on September 1. Interest is paid in arrears.)

**30. Survey/credit report.** If the lender requires either of these items, they would be a debit to the buyer (single entry).

Survey .....\$100.00

Credit report .....\$65.00

Enter the total of these items (\$165.00) on line 30.

**31. Appraisal fee.** When an appraisal fee is involved in closing a transaction, it is usually charged to the buyer, since it is a requirement of obtaining the loan. However, in some instances, the seller in the sales contract may agree to pay for the appraisal at closing. The broker must check the Contract to Buy and Sell in each situation.

Appraisal fee.....\$400.00

**Total amount of lender payouts.** The total of payouts provided by the lender on the New Loan Statement does not go on the settlement sheet. It is merely the total of all of the debits listed by the lender. The gross loan amount minus the total of charges is equal to the net proceeds.

Total payouts.....\$30,613.14

**Last line above the double line.** Traditionally, this net loan proceeds figure is entered on the last line above the subtotals. It represents money the lender will actually provide to the closing. If the broker is closing the transaction, the lender will provide good funds (often by wire transfer).

The entry is a single entry debit to the broker. It is actually deposited into the escrow account, allowing the broker to write the other checks (amount due to the seller, commission, etc.).

Net loan proceeds.....\$56,186.86

At this point, much of the settlement sheet is filled in with single entries. The single entry debits for the seller, buyer, and broker must equal the gross loan amount on line 3.

## Broker Details

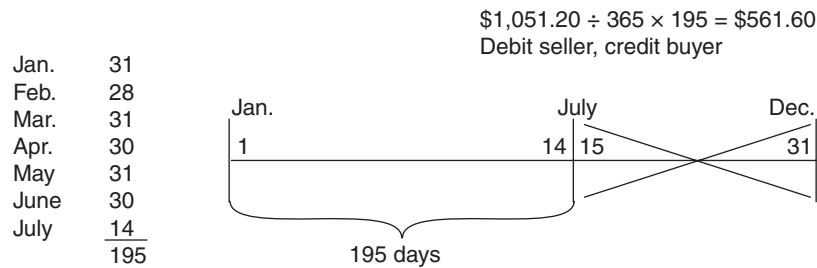
These will be double entries.

Now it is time to finish the closing worksheet by entering the rest of the financial details from the contract and other sources. These are things with which the lender is not involved. If there should be a duplicate entry mentioned, the lender is paying it, so do not duplicate the charges.

Work from line 1 down to ensure that all lines have been considered.

1. Purchase price	\$110,000	Credit seller, debit buyer
2. Deposit	\$5,000	Credit buyer, debit broker
8. Closing fee	\$150—debit seller and buyer each \$75, credit broker \$150	
9. Notary	Witness to seller signing deed—debit seller \$1, credit broker	
16. Certificate of taxes due	The tax certificate is normally charged to the buyer since it is for the benefit of the buyer.	
	\$15	Debit buyer, credit broker
18. Taxes for current year	Debit the seller and credit the buyer the prorated amount as explained in Unit 1.	

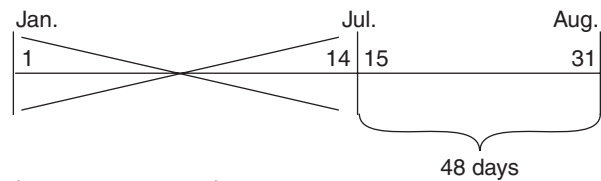
Taxes for current year = \$1,051.20



32. **Water and/or sewer.** Review Unit 1, Discussion for Settlement Exercise 1, line 32. This item is not normally on the lender’s statement, so it would be a double entry.

\$27.60 water and sewer—paid for June 1 through August 31 (92 days)

Jul.	17
Aug.	31
	48



\$27.60 ÷ 92 × 48 = \$14.40  
 Debit buyer, credit seller

\$27.60 water and sewer, paid for June 1 through August 31 (92 days)

37. **Broker’s fee.** Debit the seller and credit the broker (the employing broker is writing a check from the escrow account to the brokerage operating account to disburse commissions).

\$5,500 debit seller, credit broker

## Other Items

The following are items not printed on the closing worksheet that may be found on a new loan closing:

- **Realty tax service fee:** a service that provides property tax information to the lender on their reserve accounts
- **Underwriting fee:** a fee paid to the underwriter to analyze the loan documents
- **Loan document preparation fee:** a fee paid to the loan processor to prepare the loan documents for review)
- **MIP (mortgage insurance for FHA loans) and PMI (private mortgage insurance for conventional loans)**
- **VA funding fee**
- **Flood plain certification:** a fee to provide the lender with a certificate that the subject property is not in a flood plain. If the property were found to be in a flood plain, the buyer would be required to purchase flood insurance in addition to hazard insurance.

## Below the Double Line

- The procedure for a new loan is the same as for a loan assumption closing.

## Subtotals

- The subtotals are the sums of all the amounts in each column.

## Balance Due To/From Seller

- The balance equals the subtotal of the seller's credits minus the subtotal of the seller's debits.
- Enter the difference under the smaller of the two numbers (usually seller's debit).
- In most closings, the seller will receive a check from the broker's escrow account. Enter the balance due to/from seller on the same line in the broker credit column.

## Balance Due To/From Buyer

- Find the difference between the subtotal of the buyer's debits and the subtotal of the buyer's credits.
- Enter the amount under the smaller of the two numbers (usually buyer's credits).
- The buyer brings this amount in good funds, usually in the form of a cashier's check.
- The check is deposited into the broker's escrow account. Debit the broker the amount of the check on the balance due to/from buyer line.

**Totals**

- Total each line from the subtotals down.
- The totals for each set of columns (seller, buyer, and broker) must be equal.
- The totals were forced to be equal for the seller and buyer.
- When the broker's totals are equal, the broker has accounted for all of the funds deposited into and withdrawn from the escrow account.

**SETTLEMENT EXERCISE 4: SETTLEMENT CLOSING  
WORKSHEET TIPS—NEW LOANS**

1. Everything paid by the lender will be a single entry.
2. Total all single entry buyer and seller debits, and balance these with the lender's dollar amounts paid out.
3. Study all facts carefully. Be alert to anything the broker handles.
4. Reconciliation will be the same as in an assumption.
5. Double entry indicates that entries are the same for assumptions and new loans.



	Debit/Credit	Tips
1. Selling price	Credit seller, debit buyer	Double entry
2. Deposit, paid to:	Credit buyer, debit broker	Double entry
3. Trust deed, payable to: <i>new loan</i>	Credit buyer	<b>Single entry</b> (lender will provide this amount)
4. Trust deed, payable to: <i>seller's second</i>	Debit seller, credit buyer	Double entry
5. Trust deed, payoff to: <i>old loan</i>	Debit seller	<b>Single entry</b> (lender will pay)
6. •Interest on loan assumed	N/A	
7. Title insurance premium Mortgagee's policy	Debit seller (owner's policy) Debit buyer (mortgagee policy)	Single entry (lender will pay)
8. Closing fee	Debit seller/buyer per contract, credit broker	Double entry
9. Notary	Debit seller/buyer per document, credit broker	Double entry
10. Title exam by: buyer's attorney	Debit buyer, credit broker	Double entry
11. Recording: warranty deed	Debit buyer	<b>Single entry</b> (lender will pay)
12. Trust deed	Debit buyer	<b>Single entry</b> (lender will pay)
13. Release	Debit seller	<b>Single entry</b> (lender will pay)
14. Other		
15. Documentary fee	Debit buyer	<b>Single entry</b> (lender will pay); must have
16. Certificate of taxes due	Debit buyer	<b>Single entry</b> (lender will pay)
17. Taxes for preceding year(s)	Debit seller	<b>Single entry</b> (lender will pay)
18. •Taxes for current year	Debit seller, credit buyer	Double entry (SOB)
19. Tax reserve <i>prime charge</i>	Debit buyer	Single entry (lender will pay)
20. Special taxes	Depends on contract	Analyze carefully (could be single or double entry)
21. Personal property taxes	N/A	
22. Hazard insurance premium assumed	N/A	
23. Premium for new hazard insurance	Debit buyer	<b>Single entry</b> (lender will pay)
24. Hazard insurance reserve	Debit buyer	<b>Single entry</b> (lender will pay)
25. FHA mortgage insurance assumed	N/A	
26. FHA mortgage insurance reserve	N/A	
27. Loan discount points	Depends on contract	<b>Single entry</b> —analyze carefully
28. Loan origination fee	Debit buyer	<b>Single entry</b> (lender will pay)
29. Interest on new loan	Debit buyer	<b>Single entry</b> (lender will pay)
30. Survey	Depends on contract	<b>Single entry</b> (lender will pay credit report)
Credit report	Debit buyer	<b>Single entry</b> (lender will pay)
31. Appraisal fee	Depends on contract	<b>Single entry</b> (lender will pay)
32. •Water and/or sewer	Analyze carefully	Double entry
33. •Rent	Debit seller, credit buyer	Assuming rent is prepaid, SOB
34. Security deposits	Debit seller, credit buyer	
35. Loan transfer fee	N/A	
36. Loan payment due	N/A	
37. Broker's fee	Debit seller, credit broker	Double entry
38. Seller's attorney	Debit seller, credit broker	Double entry
39. <i>Net loan proceeds (from lender)</i>	Debit broker	<b>Single entry</b> on broker debit column
<b>SUBTOTALS</b>		Double entry
Balance due to/from seller		Double entry
Balance due to/from buyer		Double entry
<b>TOTALS</b>		Double entry

• = proration items    Arrears = SOB (solve left side)    Advance = BOS (solve right side)

## DEBIT AND CREDIT CHART FOR CLOSINGS

<b>Selected Items</b>	<b>Details to Remember</b>	<b>Settlement Worksheet</b>	<b>Closing Statement</b>
Sales price		Debit buyer, credit seller	Appears on both buyer's and seller's
Earnest money		Credit buyer, debit broker	Appears only on buyer's
Assumed loan amount	Principal remaining on loan assumed by buyer	Debit seller, credit buyer	Appears on both buyer's and seller's
Seller-carry loan amount	Reduces seller's cash at closing	Credit buyer, debit seller	Appears on both buyer's and seller's
Broker's commission	Negotiable; usually seller pays	Debit seller, credit broker	Appears only on seller's
Owner's (buyer's) title insurance	Seller pays owner's policy	Debit seller, credit broker	Appears on seller's
Mortgagee's (lender's) title insurance	Buyer pays lender's policy	Debit buyer, credit broker	Appears only on buyer's
Notary fee for warranty deed	Person who signs document pays notary; seller signs deed	Debit seller, credit broker	Appears only on seller's
Recording of warranty deed	Recording deed benefits buyer/grantee	Debit buyer, credit broker	Appears only on buyer's
Notary fee for deed of trust	Buyer signs promissory note and deed of trust at closing	Debit buyer, credit broker	Appears only on buyer's
Tenant security deposits	Not prorated; belong to tenants	Debit seller, credit buyer	Appears on both buyer's and seller's
Rents	Prorated; collected in advance; seller always owes buyer	Debit seller, credit buyer	Appears on both buyer's and seller's
New loan amount	Figures from the new lender	Credit buyer, single entry	Appears only on buyer's
<b>Net loan proceeds</b>	<b>New loan closing</b>	<b>Debit broker only</b>	<b>Does not appear on either</b>
Taxes for the preceding year if unpaid	Credit broker to pay the lien in assumption; in new loan, single entry	Debit seller, credit broker in assumption	Appears only on seller's
Special taxes (special assessments)	May be paid off or assumed	If assumed, no entry; if paid, debit seller	Appears only on seller's

## SOLUTION FOR SETTLEMENT EXERCISE 4

Exercise #5: New Loan (Net Proceeds)	SELLER				BUYER				BROKER			
	DEBIT		CREDIT		DEBIT		CREDIT		DEBIT		CREDIT	
1. Selling Price			110,000	00	110,000	00						
2. Deposit, Paid to: <i>Western Realty</i>							5,000	00	5,000	00		
3. Trust Deed, Payable to: <i>new first</i>							86,800	00				
4. Trust Deed, Payable to:												
5. Trust Deed, Payoff to: <i>old lender</i>	26,740	72										
6. Interest on Loan Assumed												
7. Title Insurance Premium	750	00										
a. Extended Title Insurance												
b. Mortgagee's Policy					100	00						
8. Closing Fee	75	00			75	00					150	00
9. Notary	1	00									1	00
10. Title Exam by: <i>Buyer's Attorney</i>												
11. Recording: Warranty Deed					6	00						
12. Trust Deed— <i>new first TD</i>					31	00						
13. Release— <i>old first TD</i>	16	00										
14. Other— <i>second TD</i>												
15. Documentary Fee					11	00						
16. Certificate of Taxes Due					15	00					15	00
17. Taxes for Preceding Year(s)— <i>paid; \$1,051.20</i>												
18. Taxes for Current Year	561	60					561	60				
19. Tax Reserve					438	00						
20. Special Taxes												
21. Personal Property Taxes												
22. Notary Fees—paid by lender					1	00						
23. Premium for New Insurance					654	00						
24. Hazard Ins. Reserve					109	00						
25. Mortgage Ins. Assumed												
26. Mortgage Ins. Reserve												
27. Loan Service Fee (Buyer)					868	00						
28. Loan Discount Fee												
29. Interest on New Loan					323	42						
30. Survey					100	00						
Credit Report					65	00						
31. Appraisal Fee					400	00						
32. Water and/or Sewer			14	40	14	40						
33. Rents												
34. Security Deposits												
35. Loan Transfer Fee												
36. Loan Payment Due												
37. Broker's Fee	5,500	00									5,500	00
38. Seller's Attorney												
39. <i>Net Loan Proceeds</i>									56,186	86		
Subtotals	33,644	32	110,014	40	113,210	82	92,361	60	61,186	86	5,666	00
Balance Due TO/FROM Seller	76,370	08									76,370	08
Balance Due TO/FROM Buyer							20,849	22	20,849	22		
TOTALS	110,014	40	110,014	40	113,210	82	113,210	82	82,036	08	82,036	08

## **HOMEWORK BEFORE UNIT 4**

1. Review Settlement Exercise 4: Settlement Closing worksheet tips and Debit and Credit Chart for Closings.
2. Review the Unit 4 Final Exam Study Guide.
3. Complete your online Final Exam.

# UNIT 4

## Final Exam Study Guide

### STUDY GUIDE

#### Colorado Contracts & Regulations

The following items should be reviewed prior to taking the Contracts and Regulations Final Exam:

1. Commission rules (CREM) – Unit 1
2. *Conway-Bogue* decision – Unit 1
3. Brokerage relationships – Unit 1
4. Listing contract – Unit 2
5. Single-party listings – Unit 2
6. Right-to-buy contract – Unit 2
7. Rebates of commissions – Unit 2
8. Review Contract to Buy and Sell Real Estate – Units 3 and 4
9. Seller concessions – Unit 4
10. Forms – Unit 5
  - Seller's Property Disclosure
  - Square Footage Disclosure
  - Agreement to Amend/Extend Contract
  - Listing Contract Amendment
  - Closing Instructions
  - Real Property Transfer Declaration
11. Water rights – Unit 5

12. Errors and omissions insurance – Unit 5
13. Supervision by employing brokers – Unit 5
14. Foreclosure – Unit 5
15. Unlicensed assistants – Unit 5
16. Subdivision registration requirements – Unit 5
17. Fair housing – Unit 6
18. Property management – Unit 6
19. Requirements for licensing – Unit 6
20. Continuing education – Unit 6
21. Selling real estate options and securities – Unit 6
22. Inactive licenses – Unit 6
23. Advertising and trade names – Unit 6
24. Investigations and discipline of licensees by the Colorado Real Estate Commission – Unit 6
25. Dual contracts – Unit 6
26. Appraisal licensing – Unit 6

## **Closings and Settlement**

1. Debit and credit chart in Unit 3
2. Proration of the following:
  - a. Interest, taxes, rent, and water
  - b. The different processes used to prorate in state and national questions
3. Special assessment taxes
4. The difference between the six-column closing worksheet and closing statements
5. New loan entries
6. How points and loan origination fees are charged
7. Responsibility and obligations of brokers for the closing
8. How errors in lender figures or other items are handled at closing
9. How the Contract to Buy and Sell impacts the closing
10. Closing entity and nonresident withholding tax

# APPENDIX

# A

## Postlicensing Information

- Unit 1:** Finding a Brokerage Firm and Achieving Professionalism
- Unit 2:** Prospecting for Listings
- Unit 3:** Pricing the Property to Sell
- Unit 4:** Making the Listing Presentation
- Unit 5:** Brokerage Relationships and Listing Contracts in Colorado
- Unit 6:** Working With Buyers
- Unit 7:** Sales and Option Contracts
- Unit 8:** Writing and Presenting the Offer
- Unit 9:** Exploring Mortgage Alternatives
- Unit 10:** Acquiring Financing for the Property
- Unit 11:** Closing Real Estate Transactions





# UNIT 1

## Finding a Brokerage Firm and Achieving Professionalism

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Interview with a brokerage firm and know the five most important points to consider when looking for a firm.
- › Explain why a real estate broker-associate needs additional knowledge and experience to become a professional.
- › List three types of communication skills that the professional real estate broker-associate must master.
- › List the three types of knowledge a real estate broker-associate needs and distinguish the differences between each type.
- › List the five requirements for effective goal setting.
- › List at least 10 services that an unlicensed personal assistant can perform.

### KEY TERMS

body language  
jargon  
marketing knowledge  
nonverbal communication  
prioritize

product knowledge  
professional ethics  
technical knowledge  
time management  
to-do list

verbal communication skills  
written communication  
skills

### OVERVIEW

Finding a brokerage firm and starting a successful business are by far the most important first steps for new broker-associates. Upon completion of this unit, you will know how to look for a firm and the questions to ask to determine the best fit between you and your new employing broker.

Real estate brokers are, for the most part, self-employed and in charge of their own small business. Developing the habits and skills to start and keep a successful business are among the challenges facing a new licensee. In this unit, you will find information on acquiring these habits and planning to begin a successful career.

## FINDING A BROKERAGE FIRM AND AN EMPLOYING BROKER

New Colorado licensees (broker-associates) must work under an employing broker for the first two years after licensing. For a new broker-associate, the decision of which firm to join can seem nearly as difficult as passing the state licensing exam. But do not worry. If you interview several firms and take the time to get to know the employing broker, sales manager, mentor, and other brokers of the firm before joining, you will undoubtedly find the right fit. Moreover, while Colorado law requires that a broker-associate work under an employing broker for two years, it does not have to be for the same employing broker or for the same firm. If a broker-associate changes firms, the broker-associate and the employing brokers, both the old and new, simply notify the Colorado Real Estate Commission about the change of address for the broker-associate.

The five major areas broker-associates should be concerned with as they start the interview process are

- training;
- relationship with the employing broker, manager, or mentor;
- location of the firm;
- costs to start; and
- commission splits and desk fees.

### Training

Upon completing the required prelicensing education, most broker-associates have a basic understanding of real estate law, Colorado contracts, trust accounting, and closings. Each of these topics involves concepts that the broker-associate must put into practice once a buyer or seller is found. The training most new broker-associates need involves how to find business in the first place (i.e., buyers and sellers) and how to work with buyers and sellers once you find them. As in any type of sales, there are a variety of ways to develop a client base. Training programs present broker-associates with multiple approaches and help them develop a personal business plan that identifies specific, measurable goals and the approaches that they will use to achieve those goals. Many effective training programs combine lectures and book learning with hands-on application to help get new licensees off to a fast start. Additionally, many companies offer mentors or training coaches to help new licensees get started.

Most new broker-associates are surprised to learn that they are solely responsible for determining their success—including what they do every day. With no formal boss to report to, or specific tasks to perform, the broker-associate alone decides what time to begin work each morning, what to do each day, which evenings to work late, which weekends to work, and so on. Keep in mind, though, that most real estate brokers are self-employed independent contractors and are paid on a commission-only basis. If they don't sell, they don't get paid. It is incumbent upon broker-associates to develop a work schedule and learn to meet the goals they've set each day. A good training program can provide the tools needed to earn a living selling real estate, but, of course, it's up to broker-associates to implement what they learn.

## **The Relationship With the Employing Broker, Sales Manager, Mentor, and Other Brokers**

Training is imperative to getting a good start in business. Still, the first time a new broker-associate gives a listing or buyer presentation or fills out a purchase contract can be daunting. Having a seasoned professional to help is invaluable. In many offices, the new broker-associate is expected to turn to the employing broker or sales manager for assistance, but often the broker-associate's first line of support is their mentor. The broker-associate should make sure there is a complete understanding of the expectations of all these parties. Is it acceptable to call the managing broker on a Sunday afternoon for help with writing an offer? Will the managing broker go to the first listing appointment, closing, or other appointment with the new broker-associate?

Many firms have mentor programs that give new broker-associates access to a broker to help them as they grow their business. Each firm handles these relationships differently. Often, broker-associates will share part of their commission from a sale with their mentor. New broker-associates should have the same understanding of what assistance the mentor will give them as they would with a sales manager or employing broker. Putting the understanding between the mentor and broker-associate in writing should make misunderstandings less likely. Ask, "What is my mentor's responsibility to me?"

It is also important that the broker-associate feels comfortable with the office culture. There are a variety of office policies and cultures that address issues such as required office hours (if any), frequency of office meetings, and acceptable office attire. Before joining the firm, the broker-associate should try to attend a sales meeting or walk around the office and meet the other broker-associates to determine whether the office fits his personal style.

## **Location of the Firm**

Electronic access allows most real estate brokers to do much of their business from home. Nevertheless, new broker-associates may wish to select an office relatively close to their home since they may be expected to attend office trainings in person or take floor duty (if applicable), and they may want to use the office equipment. Some broker-associates use the office conference rooms to meet clients, although most meet their clients at a location outside of the office. New broker-associates may find that having an office close to home is most convenient.

## **Costs to Start**

Compared to the costs of starting most businesses, the start-up costs for broker-associates are relatively low; however, there are important costs to be aware of. It takes many new broker-associates several months to earn their first commission; therefore, new broker-associates must have enough personal savings or another income source to live on until they begin generating income from their real estate sales activities. Some of the costs involved in doing business as a broker-associate include errors and omissions insurance, license fees, board of REALTOR® dues, multiple listing service (MLS) fees, a computer and related equipment, contract and database software, a cell phone, website fees, and automobile-related expenses. Other costs may include marketing, lawn signs, lockboxes, business cards, presentation folders, and postage. Some firms will charge the broker-associate for portions of the office training as well. The broker-associate should discuss with each potential employing broker the estimated start-up costs with the company and if the company helps new brokers with any of these expenses. Many companies have computer systems and software available at the office, which may save broker-associates the cost of acquiring these items on their own. However, most require a personal subscription that can be accessed from your computer or device.

## Commission Splits and Desk Fees

When a sale is made, the broker-associate must relinquish a portion of the commission earned to the employing brokerage firm. This is called the commission split. Nearly every employing brokerage company has different ways of splitting fees with their broker-associates. Typically, as a new, unproven real estate salesperson, the broker-associate will not be able to negotiate a different split than the standard split that the firm offers all new broker-associates. However, after time, experience, success with sales, and proving she has the skills and ability to sell real estate, a broker-associate may be in a position to negotiate a more advantageous commission split with her employing broker.

Some real estate firms offer a straight 50% commission split plan, where new broker-associates agree to pay the employing brokerage firm 50% of the commissions they generate. Many firms offer a higher split (e.g., 70%/30%). In addition to the commission split, most companies require broker-associates to pay monthly fees and cover most, if not all, of their own business expenses. If the brokerage firm says they offer a 70% split, broker-associates keep 70% of their commissions and agree to pay the employing brokerage firm 30%. Some firms have an annual cap that allows broker-associates to keep more of their commissions after reaching specified earning levels. Arrangements vary with each brokerage firm.

Other companies offer plans that allow broker-associates to keep a higher percentage of their commissions, even 100%, but require that they pay higher monthly desk or office fees. These fees are usually based on what it costs the employing broker to provide the office space, equipment, and other resources that benefit everyone in the firm. Still other firms offer a combination desk or office fee and commission split. While it is important to understand the commission split plan of the firm the broker-associate chooses, it is equally important that the firm the broker-associate selects fits her professional style, provides adequate support and training, and provides an opportunity for growth. After all, even the most attractive commission split plan will mean little if the broker-associate has not received the training to grow her business and to position herself for success.

See Figure 1.1 for a list of issues and questions to ask employing brokers during the process of interviewing firms.

**Figure 1.1: Questions to Ask Employing Brokers**

As a new broker-associate, to activate your license you must have an employing broker that agrees to hire you. There are a number of issues that need to be considered before signing with a brokerage firm:

1. Are you planning on working full- or part-time?
2. Do you plan to work mostly from home or do you need to have an office at the brokerage?
  - How far are you willing to travel to get to your office?
3. What do you need and expect the brokerage to offer you?
  - Do you want training?
  - Do you want to work with a mentor?
  - Do you want to be part of a team or work on your own?

**Sample Questions to Ask Brokers**

At many firms, the interviewer will tell you all about what the firm offers—including commission splits, start-up and recurring costs (fees), and what technology is provided—without you having to ask questions. You should review the following questions and write down the ones you want to be sure you get answers for. Before scheduling the interview, here are a few:

1. How long has the firm or office been in business?
2. How long has the broker or manager been in the real estate business?
3. Does the office belong to a board of REALTORS®? Which one?
4. What was last year's gross sales volume?
5. What are the office hours?
6. Is the office open on weekends or holidays?
7. How many agents are currently affiliated with the firm?
8. How long have the current associates been with the firm?
9. What advanced REALTOR® designations are there in the office?
10. Is there a formal training program?
  - How long is it?
  - What does it cover?
  - Is there a charge?
  - What is the success rate?
  - Is there a company-sponsored follow-up program or ongoing training?
  - Do I have to come into the office for trainings or are they virtual?
11. How many new brokers make a sale in the first three months?
12. What is the new agent retention and success rate for the last year?
13. Does the firm encourage or pay for advanced training?
14. What is the desk or office arrangement?
15. Is floor time offered to or required of new agents?
16. Are there regularly scheduled office meetings?
17. Does the office tour new listings?
18. What is the commission structure?
  - Is it graduated based on production?
  - Are there franchise fees?
  - Transaction fees?
  - Processing fees?
  - Any other fees?
  - Is there a desk or office rental fee?

**Figure 1.1: Questions to Ask Employing Brokers (continued)**

19. What does the firm pay for?
  - Business cards?
  - Yard signs?
  - Copies?
  - Postage?
  - Direct lines?
  - Voicemail?
20. What equipment does the firm have available for associates to use?
  - Computers?
  - Color printer?
  - Scanner?
  - Copier?
  - What software does the firm have available to agents?
21. Is the office wired for a network or does it offer Wi-Fi?
  - Does the office have an internet presence?
  - Does the office have a website?
  - What other office equipment is available for agent use?
22. Does the firm specialize in a particular area?
23. Does the firm specialize in a specific type of property?
  - Will I be restricted from prospecting any particular area?
24. What is the firm's marketing program?
25. Is there an in-office transaction coordinator?
26. Does the firm have a relocation department?
  - What percentage of the firm's business is relocation?
27. Is there an in-office loan officer?
28. Does the firm offer health insurance?
29. Does the firm offer a retirement plan?
30. Does the firm have a mentor program?
31. How much are the estimated costs to get started?
32. How do I get started finding leads?
33. How does the firm help their broker-associates keep up with industry changes while continuing to maintain a profitable business?

**ACHIEVING PROFESSIONALISM**

Customers of real estate licensees expect them to be knowledgeable, organized, and effective; however, professionalism is not easily achieved. Professional knowledge and behavior result from additional study and hard work and go beyond minimum legal requirements.

The broker-associate who provides honesty, service, diligence, and knowledge tends to be more successful. The following are the basic qualities needed to better serve clients and customers:

- Professional ethics
- Communication skills
- Professional education
- Goal-setting skills and time management skills
- Knowledge of technology tools

## Professional Ethics

A distinct difference exists between what is *ethical* and what is *legal*. License laws set a minimum standard of professional behavior, while codes of ethics set a higher standard of what is honest and fair to all parties involved in a real estate transaction.

Even the appearance of impropriety may cause clients to avoid doing business with a broker-associate and the brokerage firm. The expression “perception is reality” is true; such shortcomings are very damaging to a real estate career.

The National Association of REALTORS® (NAR) has standardized a code of **professional ethics** so that all members are aware of and follow their professional responsibilities. NAR’s Code of Ethics is extremely influential, not only for REALTORS®, who are required to take a class on ethics as a part of REALTOR® association membership, but for all licensees, because ethical codes often later become license laws. The code may be the best available guideline for ethical behavior, whether a licensee is a member of NAR or not.

## Communication Skills

Communication is the core of the real estate brokerage business. A licensee may be knowledgeable, competent, and ethical, yet be unable to help customers successfully because of a lack of communication skills. The three types of necessary communication skills are

- verbal,
- written, and
- nonverbal.

### Verbal Communication Skills

Talking to buyers, sellers, appraisers, surveyors, and other licensees enables the professional to share information, ask questions, and better understand the needs of others. The professional must be able to express information completely, honestly, and clearly. The individual who fails to master **verbal communication skills** may be misunderstood, appearing incompetent or even dishonest.

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#### Related website

Toastmasters  
International:  
[www.toastmasters.org](http://www.toastmasters.org)

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Community colleges and universities offer communication and public speaking classes to the public. One inexpensive way to learn to speak effectively is by joining a Toastmasters Club, a nonprofit service organization devoted to enhancing verbal communication skills. Many real estate licensees point to their years in Toastmasters as a key factor in their success.

When you prepare for an oral presentation, you should organize the presentation logically and know exactly what you are going to say. Word choice is important. For instance, the statement “We can finish the deal by the end of the month” would sound better as “We should be able to close the transaction by the end of the month.”

**Jargon** is a word or expression related to a specialized vocation that a layperson might not understand. Licensees should avoid using jargon. For example, the term *floor duty* describes the period during which a broker-associate is entitled to take all customer calls. While it’s a well-known expression in real estate circles, it is not as familiar to consumers. A potential buyer who calls the office for information on a listed property and is told “Just a minute—I’ll let you talk to the associate on the floor” may wonder whether there has been an accident or just a lack of chairs. By avoiding jargon, a real estate professional helps clients and customers better understand the information the professional is trying to relate.

## Written Communication Skills

Letters, email, flyers, social media posts, and other forms of written communication are often the first impression the public has of a licensee. Bad grammar and misspellings may reflect poorly on the licensee and the brokerage firm. Written communication skills are even more important for writing a contract provision. An ambiguous clause may result in a lost sale, a lawsuit, or disciplinary action by the Colorado Real Estate Commission.



### FOR EXAMPLE

Les shows a town home to a married couple who are interested in purchasing it even though the property has been poorly maintained. The seller has told Les that he would be willing to make reasonable repairs if the buyers include them in the sales contract. So Les writes the following special clause in the contract:

“Seller agrees to remodel the town home and put everything into first-class condition.”

Based on this clause, what will the buyer expect?

What will the seller want to do?

Is there a possibility for miscommunication here?

How should this clause have been written?

**Written communication skills** may be enhanced by taking courses at a community college or reading books on how to improve writing skills. A dictionary and a spelling and grammar check within any programs you use to compose messages are minimum requirements for achieving better written communication.

## Nonverbal Communication Skills

**Nonverbal communication**, often called **body language**, is also very important in sales. The real estate broker-associate who understands body language will be better able to read the attitudes of customers and develop body language that can make a customer feel comfortable and establish rapport. Often, nonverbal communication can be far more revealing than what a person says. Some obvious body language styles include those described in Figure 1.2.

A real estate broker-associate who wants to be more effective might consider using the following body language:

- Offer a firm, but not hard, handshake.
- Usually, make direct eye contact when you are talking or listening. Staring without blinking or looking away or down all the time may be disconcerting to the listener. Persons from certain cultures may perceive constant direct eye contact as disrespectful.
- Don't cross your arms or legs. Keep your arms open and relaxed.
- Lean forward into the conversation to display your interest. Leaning backward, especially if your hands are joined behind your head, may be perceived as a sign of superiority or aloofness.



**Related website**

The University of California has a website on nonverbal communication: <http://nonverbal.ucsc.edu>.

**Figure 1.2: Body Language Indicators**

Body Language	Probably Means...	Comments
Pyramiding fingertips—the classic “banker” look	I’m superior to you, and I’m making some judgments about you	Don’t do this when talking to a customer
Pyramiding, leaning back in the chair with hands joined behind the head—the “boss”	I’m superior to you; you have less status here	Don’t do this when talking to a customer
Arms folded across the chest	Closed, defensive	Bad sign; you’ll get nowhere in this presentation until you get the listener loosened up
Legs crossed at the knee away from the listener with body facing to the side	Closed, defensive	Bad sign; you’ll get nowhere in this presentation until you get the listener loosened up
Customer looking away (no eye contact) during a sales presentation	Closed, often unfriendly	Bad sign; unlikely to buy until you can establish rapport
Palms toward the person just before speaking	Stop talking; I have more important things to say	Don’t do this when talking to a customer
Stroking the chin (mostly males); fingertips to the neck (mostly females)	Sign of seriously considering the proposal	Get ready to write the offer
Scratching the head	Thinking; may be about to make a decision	Ask to help with any questions the customer may have
Staring at the ceiling	Thinking; trying to remember a fact	Ask to help with any questions the customer may have
Leaning forward into sales presentation	Interested, attentive	Good sign; you’re doing something right
Frowning during sales presentation	May indicate the customer disagrees or does not understand some point	Trouble; try to ask a question to find out what’s happening here
Hands hiding mouth while person is talking	Sometimes a habit of people who are not speaking honestly	Probably okay, but some information may be incorrect
Hands on hips, head bowed, staring at you	Aggressive stance; challenge	This could mean trouble

**FOR EXAMPLE**

Anita is making a listing presentation to Jack, a for sale by owner. She notices Jack has faced to the side, folded his arms over his chest, and looked in another direction.

What feedback is Jack giving Anita about her presentation?

**Professional Education**

Licensees enhance their professionalism through continuing education. The law requires continuing education before renewal of a license, but many professionals take more courses than are required by the law. National organizations award professional designations to

graduates of their educational programs. These designations make consumers aware of those persons who have exceeded the legally required continuing education.

Other types of education, when combined with formal instruction, also enhance a licensee's competence. Three types of knowledge broker-associates need are

- technical knowledge,
- marketing knowledge, and
- product knowledge.

### **Technical Knowledge**

**Technical knowledge** provides the tools of the business, such as completing contracts properly, knowing sellers' and buyers' costs, and understanding the comparative market analysis process. This text provides technical knowledge in the following areas:

- State and federal laws
- Preparing a comparative market analysis
- Preparing a listing or purchase contract
- Qualifying a buyer
- Understanding financing plans
- Reviewing settlement statements
- Analyzing real estate investments

Broker-associates should not work in the field without the appropriate technical knowledge. For example, broker-associates will feel quite incompetent if they cannot fill out the contract form. Technical knowledge also includes knowledge about state and federal laws, such as fair housing and antitrust laws.



#### **FOR EXAMPLE**

Traci has been in the real estate business for about a month and is working with her first buyer clients, who were referred to her by a close friend. She shows them a home listed by another broker-associate in her office. The buyers immediately start to talk about where to place their furniture. "We think this is the one," they tell Traci.

It is Saturday afternoon and Traci is unable to contact the broker to answer some questions about how to complete the required forms. Nervously, she tells the buyers, "You know, I hate to see you rush into anything. There are some other houses out there you might like better. I can show them to you tomorrow, if you like. That'll give you time to think about it all, too!"

What is Traci's main objective at this moment?

How could Traci have been better prepared for this situation?

### **Marketing Knowledge**

Learning how to sell real estate comes from **marketing knowledge**. It encompasses the knowledge of psychology and the ability to assess a consumer's specific housing needs. This text provides marketing knowledge in the following areas:

- Business planning (marketing yourself to potential clients)
- Prospecting for listings and buyers

- Making an effective listing and buyer presentation
- Showing and selling the property

Many sales training books and tapes are available commercially. The National Association of REALTORS® and local boards of REALTORS® offer sales training classes. Many brokerage firms hold regular sales training courses for sales personnel. Marketing knowledge is an important tool and a major part of the service consumers expect when buying and selling real estate.

### **Product Knowledge**

Clients expect their real estate broker-associates to know the market. They want the benefits of that **product knowledge** in marketing a property or finding the right property for purchase. A new practitioner should work hard to obtain that knowledge to best serve the consumer. In larger metro areas, this knowledge is often gained when a buyer or seller requests service in a particular neighborhood or area.

How does one gain product knowledge? Outstanding trainers say the most important step a new licensee can take is to become familiar with the marketplace, which means looking at properties. Some firms recommend that their new broker-associates take at least two weeks to see as many listings as possible. They suggest maintaining that product knowledge by regularly scheduling time to look at properties.

### **Setting Goals, Business Planning, and Time Management**

Setting realistic goals is extremely important in real estate sales. Because real estate broker-associates are usually independent contractors, they receive little supervision. Without a clear set of goals and a strong business plan, the licensee may lose focus and direction. Goals should be written, measurable, attainable, and flexible and should contain deadlines. Once goals have been set, the business plan shows how to achieve the goals. Time management is an important part of that plan.

A distinction can be made between goals, plans, and time management. For example, an automobile trip from Orlando to St. Louis requires all three:

- The goal is St. Louis.
- The plan is the GPS or road map on which the route is planned.
- **Time management** consists of the daily objectives: when do we leave, when do we stop for food and gas, and how far should we go today?

Goal setting should focus on marketing and the action steps to generate leads (find buyers and sellers to work with). By working from the long term (the current year) to the short term (what action or tasks to do daily), it becomes clear what a licensee must do this year, this week, and today to achieve their long-term goal. Taking appropriate action daily to generate leads (i.e., finding buyers and sellers to work with) is the key to success.

When setting these goals, the professional should always include personal and family objectives. An example of professional goal setting follows (see Figure 1.3).

Figure 1.3: Sample Long-Range Plan

Year 5	Obtain 3 professional designations	Close 10 transactions in the next 12 months	Marketing Action Plan to achieve annual transaction goal
Year 1	Finish first course	Take lead-generation classes my firm offers	Create yearly marketing plan
Month 1	Select designation and schedule first class	Ask successful brokers how they generate leads	Block time to generate leads daily

A licensee’s five-year goals are

- earning the GRI or other professional education designations,
- obtaining an employing broker’s license,
- owning a brokerage firm with 15 associates, and
- creating a marketing plan and time management plan to generate leads focusing on action steps.

Once the licensee establishes the one-year goal, it is converted into monthly and weekly goals—short-term tasks.

A new broker-associate must remember that setting income goals as an independent contractor in real estate sales is different from what it would be in a salaried position. Because of the independent contractor relationship, the broker does not pay the normal employee’s share of Social Security and Medicare taxes or pay for health insurance or other benefits. Also, the broker-associate will have expenses such as board of REALTORS® dues, license fees, education, office supplies, and advertising. To be safe, the broker-associate should estimate those costs at 35% of gross earnings. So, if the broker-associate plans to earn a net income of \$31,200 in the first year, the gross income goal should be \$48,000 ( $\$31,200 \div 0.65$ ).

Use the worksheet shown in Figure 1.4 to see what must be done today to achieve a \$48,000 gross income. If the assumptions shown are appropriate for your market area, it is simple to project how you can accomplish the goal. This example focuses on income goals, but the same exercise could be completed for other goals.

When the licensee is aware of what must be done today to achieve a long-term goal, the goals should be written out in contract form. It can be a private contract or a public document, with copies delivered to the broker and a mentor. Giving a copy to another person usually strengthens one’s commitment to succeed in the goals. A goals contract might look like the sample in Figure 1.5.

The licensee then posts the goals where they are visible. The adage “out of sight, out of mind” is true where goals are concerned.

**Figure 1.4: Goals Worksheet**


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1. During the next 12 months, I want to earn:	\$_____
2. That works out to be monthly earnings of: (Line 1 $\div$ 12)	\$_____
3. Approximately 60% of my earnings should come from listings sold (Line 2 $\times$ 0.60)	\$_____
4. Approximately 40% of my earnings should come from sales made (Line 2 $\times$ 0.40)	\$_____
<b>Achieving my listing income:</b>	
5. In my market area, the average listing commission amount is: (Get this amount from your broker.)	\$_____
6. So I must have the following number of listings sold: (Line 3 $\div$ Line 5)	\$_____
7. If only 75% of my listings sell, I have to get this many listings: (Line 6 $\div$ 0.75)	\$_____
8. It may take this many listing appointments to get a listing: (Get this number from your broker.)	\$_____
9. So I need to go on this many listing appointments: (Line 7 $\times$ Line 8)	\$_____
10. It may take this many calls to get an appointment: (Get this number from your broker.)	\$_____
11. So I have to make this many calls per month: (Line 9 $\times$ Line 10)	\$_____
12. Which means this many calls per week: (Line 11 $\div$ 4.3 weeks per month)	\$_____
<b>Achieving my sales income:</b>	
13. In my market area, the average sales commission is: (Get this amount from your broker.)	\$_____
14. So I've got to make this many sales per month: (Line 4 $\div$ Line 13)	\$_____
15. It takes about this many showings to make a sale: (Get this number from your broker.)	\$_____
16. So I must show this many properties per month: (Line 14 $\times$ Line 15)	\$_____

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**Figure 1.4: Goals Worksheet (continued)**

1. During the next 12 months, I want to earn	\$48,000
2. That works out to be monthly earnings of (Line 1 ÷ 12)	\$4,000
3. Probably 60% of my earnings should come from listings sold (Line 2 × 0.60)	\$2,400
4. Probably 40% of my earnings should come from sales made (Line 2 × 0.40)	\$1,600
<b>Achieving my listing income:</b>	
5. In my market area, the average listing commission amount is (Figure used here should be changed to fit your market.)	\$1,800
6. So I must have the following number of listings sold (Line 3 ÷ Line 5)	1.5
7. If only 75% of my listings sell, I have to get this many listings (Line 6 ÷ 0.75)	2
8. It may take this many listing appointments to get a listing (Get this number from your broker.)	5
9. So I need to go on this many listing appointments (Line 7 × Line 8)	10
10. It may take this many calls to get an appointment (Get this number from your broker.)	15
11. So I have to make this many calls per month (Line 9 × Line 10)	150
12. Which means I must make this many calls per week (Line 11 ÷ 4.3 weeks per month)	35
<b>Achieving my sales income:</b>	
13. In my market area, the average sales commission is (Figure used here should be changed to fit your market.)	\$1,800
14. So I've got to make this many sales per month (Line 4 ÷ Line 13)	0.9
15. It takes about this many showings to make a sale (Get this number from your broker.)	20
16. So I must show this many properties per month (Line 14 × Line 15)	18

Source: Edward J. O'Donnell, *30-Day Track to Success* (Tallahassee: O'Donnell Publishing, 2003)

**Figure 1.5: Goals Contract—Written goals to be given to your broker or mentor for accountability**

I, \_\_\_\_\_, have determined my career and financial goals voluntarily, independently, and without coercion. I now formally commit to the following:

During the next 12 months, I will earn (from Line 1)	\$48,000
I will obtain at least this number of listings per month (from Line 7)	2
I will go on this number of listing appointments weekly (Line 9 ÷ 4.3)	2.3
I will make this many listing calls weekly (from Line 12)	35
I will make this many sales each month (from Line 14)	0.9
I will show this many properties each week (Line 16 ÷ 4.3)	4

If I begin to fall behind, I request that my broker remind me of this commitment and prod me to stay on schedule so that I can achieve my goals.

Date \_\_\_\_\_ My signature \_\_\_\_\_

Date \_\_\_\_\_ My broker's signature \_\_\_\_\_

Date \_\_\_\_\_ My mentor's signature \_\_\_\_\_

Source: Edward J. O'Donnell, *30-Day Track to Success* (Tallahassee: O'Donnell Publishing, 2003)

## ***Daily Goals and Time Management***

Time management goes hand in hand with goal setting. Goals don't work without a schedule. Besides being measurable and attainable, a goal must have a set deadline. For example, the goal of "making as many calls or social media posts or sending as many emails as possible to prospective sellers" is attainable, but it is immeasurable because no time deadline has been established. The statement "I will make five calls to contacts in my personal database today" is clear, measurable, and more likely to be accomplished.

The licensee should set their real estate work hours before each workday starts, keep the list nearby throughout the day, and check off each item as it is completed. This provides a sense of accomplishment and motivation to continue. Some helpful points to remember about the list include the following:

- Focus only on contacting potential buyers or sellers (lead generation) for the first hour of the day. Do other tasks only after this is done.
- Include those daily tasks from the goals worksheet that are necessary to achieve long-term goals.
- **Prioritize** items on the list. Do your lead generation first; everything else can be worked in later.
- Start with the least pleasant items. ("Eat the frog first.") Completing the tough tasks first results in the ability to get on with achieving important goals.
- Establish times for completing each task. Even if they need to be adjusted later, you have established a basic guideline to follow.
- Make notes for items to include on tomorrow's list.

## ***Time Management Hints***

A licensee can do many things to help manage time more effectively:

- Schedule time off for family, recreation, exercise, and relaxation first. Failing to plan for these items can result in feelings of guilt, discontent, poor health, or burnout.
- Schedule your work hours. It may seem to your family and friends that you don't have a job because you aren't required to work in the office (or from home) from 9:00 am–5:00 pm. You must establish your work schedule and stick to it so that others will understand that your career is different but requires dedicated time to be successful.
- Your time can be rated as A, B, or C with respect to productivity. A time is most productive because it represents time spent talking with potential clients and asking them for business and referrals. B time is nonurgent, administrative work that can sometimes be handled by a personal assistant, such as creating marketing materials and posting to social media. C time is wasted time. Doubling your income may require only moving more of your workday to A time, not working twice as many total hours. See Figure 1.6 for a sample daily activity log.

**Figure 1.6: Sample Daily Activity Log**

<b>A Direct \$</b>	<b>Hours (Goal)</b>	<b>Hours (Actual)</b>	<b>Comments</b>
Prospecting for sellers	1	1	Pretty good. Got a lead for a listing.
Prospecting for buyers	1	0	Just couldn't get to this.
Making appointments with buyers or sellers			
Showing homes			
Presenting offers			
Making listing presentations			Jane said she has a good friend who needs to sell a house. Maybe I'll call her tomorrow.
Other activities that will directly produce \$:			
Calling friends for referrals	$\frac{1}{3}$	$\frac{1}{2}$	I need to do better at this.
<b>TOTAL</b>			
<b>B Office and Administrative</b>			
Prepare CMAs			
Write ads	0.5	0	
Attend office meetings	1	1	
Look at properties	2	1	Just didn't have time to see more.
Attend education meetings			
Other administrative activities:			
Prepare announcement and mail out	$\frac{1}{4.5}$	$\frac{0}{2}$	I'll try to do this tomorrow.
<b>TOTAL</b>			
<b>C Wasted Time</b>			
Stopped to shop at Dillard's	0	1	Had a sale; shouldn't have, but...
Friend stopped by the office	$\frac{0}{1}$	$\frac{1}{2}$	She had a day off and wanted to talk.
<b>TOTAL</b>			Should have arranged to see her at lunch.
			Makes me mad at myself.
<b>? Personal</b>			
Scheduled time off			
Other (describe):			
Renew driver's license	$\frac{0.5}{0.5}$	$\frac{1.5}{1.5}$	Went to the DMV; traffic snarled.
<b>TOTAL</b>			Should have just mailed it.
<b>GRAND TOTAL HOURS</b>	<b>8.0</b>	<b>7.5</b>	

- Qualify sellers and buyers based on their financial ability to complete a transaction, as well as on their motivation. Working with unqualified buyers and sellers is both a disservice to the consumers and a nonproductive use of time.
- Be on time for appointments. Being late is the quickest way to lose the confidence of customers. Plan for contingencies such as rush hour traffic, last-minute phone calls, and weather-related inconveniences.
- Understand how much each hour of your day is worth. For example, if you earn \$48,000 per year and work 290 days per year, 9 hours per day, you work 2,610 hours and the hourly rate is approximately \$18.40.
- Make cost-effective decisions. If you make \$18.40 per hour, hiring a personal assistant for \$10 per hour is more cost-effective than doing your own mail-outs and clerical work. Going home to wash the car Monday afternoon may cost you \$18.40 versus \$9.95 at a car wash.



- Utilize technology to increase productivity. Many tools are available to automate your tasks. The more your marketing is automated, the more time you have to talk to potential clients and to ask them if they plan to buy or sell in the near future.

## **Power Prospecting**

Setting high income goals requires a commitment to prospect. The three keys to prospecting success are

- numbers,
- consistency, and
- organization.

## **Numbers**

The difference between making a living and becoming a superstar is numbers. Figure 1.7 shows the real estate sales process. Notice the first activity is prospecting. Following these tips will help you become a successful prospector:

- Follow all laws and your firm's policy and procedures manual when prospecting, paying particular attention to the National Do Not Call Registry.
- Your firm may have access to a cross-reference directory that can give you information on area residents and businesses. Cross-reference directories are arranged by street addresses and numerically by phone number. Listings arranged by street addresses allow you to find all the residents and businesses on a particular street in sequence. Listings arranged by phone number allow you to find all the numbers and names for a particular area code and exchange. These types of directories are available in print, on CDs and DVDs, and online and may require an annual subscription and fee. They give current information and can filter out phone numbers that appear on the do-not-call list.
- Plan what you're going to say when you call. Be sure you ask each person, "Are you planning to buy or sell anytime in the near future? Do you know anyone who is?"  
Start by calling your network—family and friends—rather than strangers.  
Grow your contact list by attending networking functions outside the real estate field, such as service clubs (i.e., Rotary Club), book clubs, meet-up groups, or ski or bicycle clubs. Focus on what you do for fun and find ways to meet other people who enjoy that also.
- Use a prospecting tool such as The Daily 100 Power Prospecting Points Chart (see Figure 1.8). Note that this chart awards more weight to activities that are more likely to result in a listing or a sale. For example, sending a mailing to for sale by owners is worth one point, but visiting in person gives five points because it is a more productive activity.
- Stay out of the office as much as possible. The only people you'll see there are other broker-associates.
- Avoid time-wasting activities such as idle conversation, poor organization and planning, and uncontrolled interruptions. If you're worth \$18.40 per hour, four hours per week of idle conversation with associates in the office costs you nearly \$75!

It's all about prospecting. If a broker-associate can reduce wasted hours and hours spent on administrative support functions and shift them to A-level activities, income should show a dramatic increase.

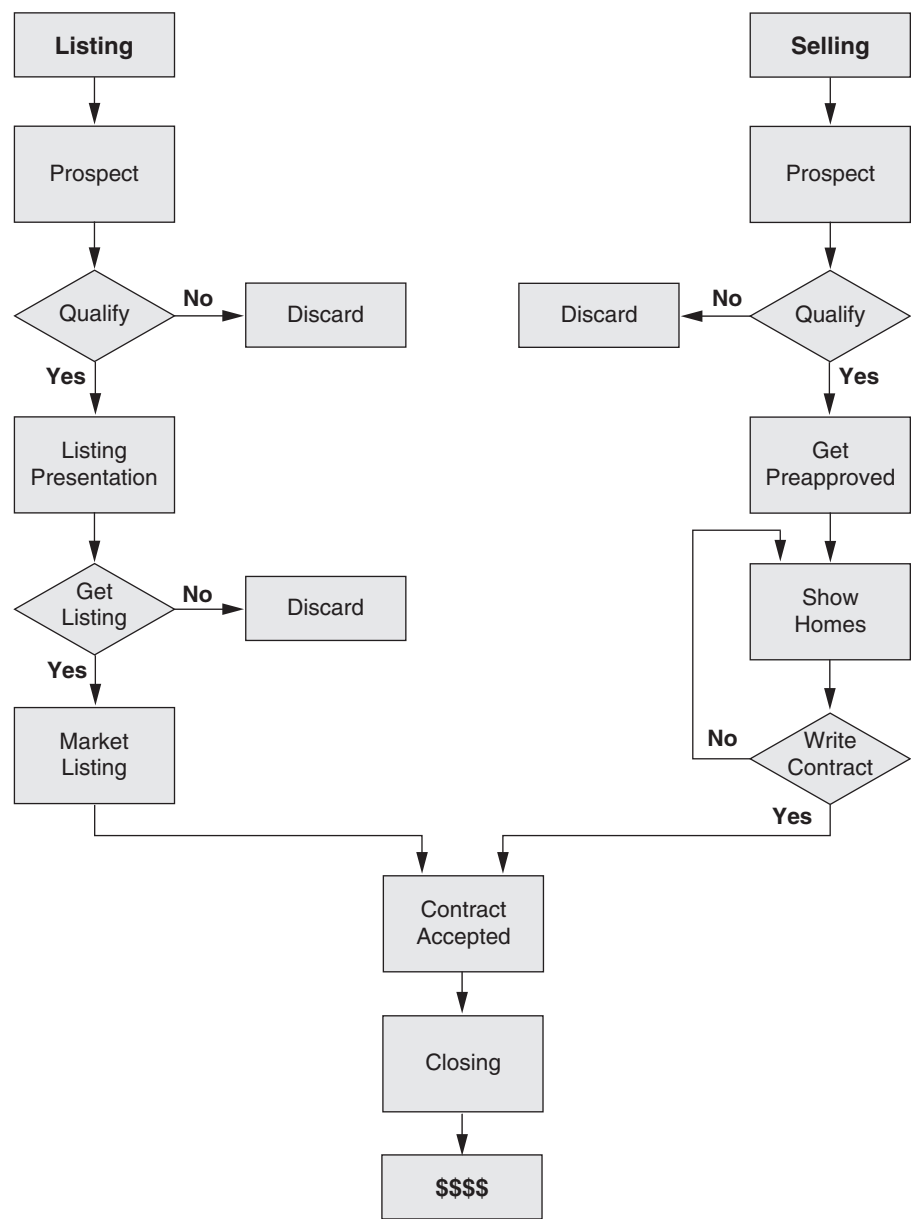
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### **Related website**

Hill Donnelly sells cross-reference directories for many market areas: [www.hilldonn.com/hd](http://www.hilldonn.com/hd).

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Figure 1.7: The Real Estate Listing and Selling Process



Directions: Complete any combination of the activities listed below. If you consistently earn at least 100 Daily Power Prospecting points, your personal income will increase dramatically!

[illegible]

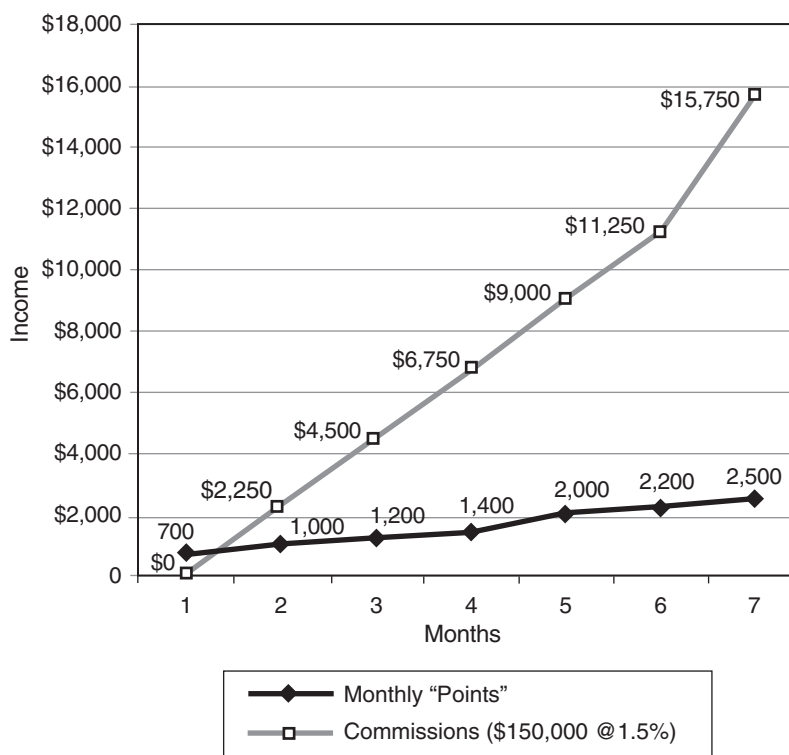
If a broker-associate decides to make a commitment to do power prospecting and is able to increase his number of contacts, his income should show a geometric increase. Figures 1.9 and 1.10 show what can happen to the income stream in seven months if a person goes from little or no prospecting to power prospecting. The figures shown won't magically work for every broker-associate but depend on the following assumptions:

- The broker-associate is articulate, likes people, and is disciplined.
- The broker-associate has finished training and knows how to
  - prospect effectively,
  - prepare a CMA,
  - make an effective listing presentation,
  - show properties,
  - ask closing questions, and
  - ask for the order.

For example, Jorge is a broker-associate who has been drifting through his start-up training program. After he completes the program, he decides to work smarter and increase his prospecting time. The first month he works 20 days and gets 700 points (35 per day). He continues to work the program, becomes more focused, and is finally able to achieve a 2,500-point month. His business increases dramatically. He finally understands that prospecting is the name of the game. While some licensees may be skeptical of the income levels shown in Figures 1.9 and 1.10, power prospectors know the numbers work.

**Figure 1.9: Jorge's Power Prospecting Program**

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7
Points on Daily 100	700	1,000	1,200	1,400	2,000	2,200	2,500
Following month business results							
Listings taken	1	1	1	2	2	2	3
Sales made	0	0	1	1	2	2	3
Listings sold	0	1	1	2	2	3	4
Total transactions	1	2	3	5	6	7	10
Commissions: (\$150,000 price with a 1.5% commission to sales associate)	\$0	\$2,250	\$4,500	\$6,750	\$9,000	\$11,250	\$15,750

**Figure 1.10: Income-to-Effort Ratios Using the Daily 100**

### ***Time Management and the Use of a Personal Assistant***

Many broker-associates use licensed and unlicensed personal assistants for help with many of the administrative duties that must be completed around a real estate transaction.

#### ***Licensed Personal Assistants***

Licensed personal assistants are invaluable and can provide all real estate services for the customers of the employing licensee, including showing and listing properties, calling prospects, and providing access to a listed property. A licensed personal assistant must be registered under the employing broker and may be paid for brokerage activities only by the employing broker.

#### ***Unlicensed Personal Assistants***

Some licensees now employ unlicensed assistants or professional marketing companies to help complete routine office activities, such as mass mailings, writing ads, and preparing comparative market analyses. Broker-associates who employ unlicensed assistants must ensure that the assistant does not perform any activities that violate the law.

An unlicensed individual may *not* negotiate or agree to any commission split or referral fee on behalf of a licensee. The unlicensed assistant may be paid as an employee or as an independent contractor. However, licensees should not share commissions with unlicensed assistants. The licensee hiring an unlicensed assistant must be very careful to avoid putting them in a position where they would be asked to offer an opinion or negotiate with a member of the public. A list of activities that may be performed by unlicensed personal assistants is shown in Figure 1.11.

If the assistant is to be paid as an employee, the employer must withhold and pay FICA and income taxes and file withholding tax reports on a timely basis. Penalties for noncompliance can be substantial. A licensed assistant who is paid a salary or assigned specific working hours or told how to do the work is an employee rather than an independent contractor. For further clarification, review the Commission Position Statements in the Colorado Real Estate Manual (CREM).

A licensee also should be aware of the liability of having employees. An accident on the job could make the licensee's employer liable, as could an employee who injures another person while running errands for the licensee.

### **Figure 1.9: Unlicensed Personal Assistant Activities**

1. Answer and forward telephone calls
2. Fill out and submit listings and changes to any multiple listing service
3. Follow up on loan commitments
4. Assemble documents for closing
5. Secure public information documents from the courthouse, utility district, and so forth
6. Make keys for company listings
7. Write ads for approval by the licensee and supervising broker, place advertising in newspapers, and so forth
8. Receive, record, and deposit earnest money, security deposits, and advance rents
9. Prepare contract forms for approval by the licensee and supervising broker
10. Monitor licenses and personnel files
11. Compute commission checks
12. Place signs on the property
13. Order items of repair as directed by the licensee
14. Prepare flyers and promotional information for approval by the licensee and supervising broker
15. Act as a courier service to deliver documents and pick up keys
16. Place routine telephone calls on late rent payments
17. Schedule appointments for licensees to show listed property
18. Be at an open house for any of the following reasons:
  - Security purposes
  - To hand out materials (brochures)
  - To respond to questions that may be answered with objective information from preprinted information
19. Answer verbal questions concerning a listing if the answer to the question may be obtained from preprinted information and is objective in nature (no subjective comments may be made)
20. Gather information for a comparative market analysis (CMA)
21. Gather information for an appraisal
22. Hand out objective, written information on a listing or rental
23. Drive a customer or client to a listing or rental
24. Give a key to a prospect at the licensee's office and nowhere else

**FOR EXAMPLE**

Do a role-playing session, assigning parts to Sharon, John, and the broker.

**Sharon** (*Excited*)

I did it! I got that FSBO over on Killearney Way to list with me! Now I have another showing appointment. I love this business. Gotta go! See you later!

**John** (*Dejected, shaking head*)

How does she keep doing it? She seems to get one listing after another. I'm still slogging along trying to finish up my daily plan. I've got eight more things to do!

**Broker** (*Sympathetically*)

Tell me what you have done today, John.

**John**

Well, I had to make copies of the plat book pages for my farm area, make up a list of all the people on Scenic Drive, take my clothes to the cleaners, shop for a financial calculator, go to the title insurance company to get a rate card, and get my car washed. I did all that.

**Broker**

What is still on the to-do list?

**John**

I still need to find listings for the guy who called while I was on floor duty yesterday and tell him about some property. I've got to get back in touch with the buyer I showed property to last week to set up another appointment.

Oh! And I need to get a market report back to my wife's friends who said they're interested in selling their house. I also got a response to the notice of sale cards I mailed last week. I need to call those people back. They said they might consider selling. And the tenants on Jackson Bluff Road think they may be ready to buy. I need to call them and set up a time.

There's just not enough time in the day!

Can you help John evaluate his time management skills so he can be as productive as Sharon?

## SUMMARY

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Licensees who meet only the minimum education requirements of the license law cannot be called professionals in the true sense of the word. To be perceived as a professional, a real estate broker-associate will do the following:

- Acquire verbal, written, and nonverbal communication skills to share information clearly and reduce the chance of misunderstandings or misrepresentation
- Acquire technical knowledge, marketing knowledge, and product knowledge
- Set goals that are prioritized properly, written, measurable, attainable, flexible, and that establish deadlines (Setting goals allows new licensees to achieve those business and personal objectives that provide the ability to grow professionally and provide better customer service.)
- Practice effective time management (Time management allows broker-associates to meet commitments and maximize their efforts to provide good service.)

## APPLY WHAT YOU'VE LEARNED

Use this list as you start your new business:

- Using the Daily 100 chart, begin recording your success in making contacts with as many potential customers as possible. Involve your broker in the program and ask for help to stay on track.
- List your personal characteristics that you believe will be of most value to you in your real estate career, then refine the list by showing which activities will best use those strengths.
- List your personal characteristics that you believe need improvement to enhance your career. Make one action plan focusing on ways to achieve those improvements and another focusing on ways to reduce the impact of those personal characteristics that are hard to change.
- At the next meeting of your board of REALTORS®, don't hesitate to give an opinion on the subject under discussion or to market your listing during the marketing time.
- Prepare a to-do list for tomorrow, arranged by priority.
- Set a goal of getting one new listing within the next seven days, and write out an action plan to achieve the goal.
- Prepare a short-term goal that includes the number of customer contacts you intend to make each day for the next 10 days.



# UNIT 2

## Prospecting for Listings

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › List the five principal sources of listings.
- › Describe at least three types of properties a licensee should not attempt to list.
- › Explain why a listing commission seems much higher than the stated percentage to the seller.
- › List at least three circumstances under which an FSBO might be ready to list right away.
- › Describe the three transactions that can be generated from a call to a for rent by owner.
- › State the principal reason that listings expire.
- › List the five categories in a leads database.

### KEY TERMS

farm  
for rent by owner

for sale by owner  
passive prospecting

power prospecting  
targeted stranger

### OVERVIEW

Learning how to be an effective and productive listing broker can make the difference between average and above average income in real estate. This unit shows you how to be above average by showing how a strong prospecting program can help build an income-producing listing inventory. The top-producing broker-associate is the one who has a strong ongoing prospecting system that allows for effectively finding ready and willing sellers and buyers. This unit shows how to start the process.

## YOU DON'T WANT THEM ALL

When prospecting for listings, qualify the properties and prioritize your efforts. Be picky. Your time is limited, and there are only so many listings you can work to get. The amount of effort required for prospecting and making a listing presentation is the same for a good listing as for a poor one. Don't spend time working to get a listing

- if the seller is not motivated,
- if the seller suggests you break the law by nondisclosure or discriminatory practices,
- in a market area you don't service, such as a rural or commercial property,
- outside of your preferred price range,
- if the property condition is so bad you would be embarrassed to show it, or
- if the owners are so rude or demanding you don't want to work with them.

The secret is to prioritize your efforts and focus only on those listings that will sell within a reasonable time with reasonable effort on your part.

## PROSPECTING OBJECTIVES

The main objective when prospecting for listings is to get an appointment to make a listing presentation. Because listings are the lifeblood of the real estate business, broker-associates must know how to find sellers who need their professional services. In this unit, the new broker-associate will learn the most productive sources of listings and how to effectively approach the sellers and obtain an appointment to make a listing presentation.

The most important sources of listings for a new broker-associate are

- for sale by owner (FSBO),
- for rent by owner (FRBO),
- expired listing,
- farming, and
- canvassing (a.k.a. knocking on doors).

Canvassing includes cold calls, knocking on doors, and direct mail, often done consistently within a certain neighborhood. Consistent, repeated contact in a variety of ways increases the likelihood that those sellers will contact you when they're ready to sell. Other sources for listings include your spheres of influence (i.e., family, friends, and acquaintances), personal contacts, notices of listings, and sales to neighbors and out-of-town owners. Notice that the discussion began with sources of listings for *new* broker-associates. In two, three, or four years, the new broker-associate who uses these sources will have the most powerful listing source of all: previous customers.

No matter which method a broker-associate uses to locate prospective listings, the broker must prepare for listing appointments carefully. Most firms offer associates a listing presentation to use that helps the broker-associate explain the benefits of listing with them and their firm. The comparative market analysis (CMA) is necessary to help price the listing. The broker-associate also must understand which costs the seller can be expected to pay, how to complete and explain the listing agreement, and how to market and service the listing.

## WHY FSBOs ARE FSBOs

If you were the owner of a property, try to think why you might consider selling the property yourself rather than listing it. Assume your home is worth \$200,000. A broker's commission of 6% would result in your paying \$12,000, a substantial amount. But if you further assume you bought the home two years ago for \$185,000, with a 10% down payment, your equity is approximately \$35,000.

Calculation: \$200,000 minus the original mortgage of \$166,500 ( $0.90 \times \$185,000$ ) less the principal paid back.

Now, the \$12,000 is much greater than 6%. It's closer to 34% of the equity, perhaps explaining why sellers might want to try it alone. It also explains why you will need a good presentation to show them why they need you.

### For Sale by Owner

The only potential prospect who we definitely know wants to sell is the **for sale by owner**. It is surprising that so few new broker-associates use this outstanding source of listings in their daily plan. The myths many broker-associates quote to avoid prospecting the FSBO market include the following:

- It takes more organizational skills to make the prospecting pay off.
- Sometimes FSBOs are not courteous to licensees who phone or visit (but remember, you can call only if the owner is not on the National Do Not Call Registry).
- They won't agree to pay the broker commission.
- It takes significant selling skills to get a listing from a FSBO.
- FSBO houses are often overpriced.
- The FSBO does not need a broker because they have the internet.

Broker-associates who master the FSBO market by adapting to its unique characteristics are able to significantly increase their listing inventories.

### FSBO Characteristics

First, anyone in sales can be much more effective with a healthy supply of empathy. **Empathy** is sensitivity to the thoughts and feelings of others. To be able to persuade an owner to list, the licensee must first understand the mind-set of that owner. Don't assume you know why the FSBO is selling on their own; ask them.

Those of us who have sold a car directly, rather than trading it in, usually did it to make more money from the sale. Whether that savings occurs is not the point; the fact is we did it for that purpose.

It's fair to assume that of all the FSBOs out there, a large percentage are trying to sell without a broker in order to save the commission. It's also likely that only a certain set of circumstances will change that mind-set. However, it is equally likely the FSBO may unsuccessfully try to sell on their own before listing with a broker if the FSBO

- is moving out of town and has a deadline to sell,
- is concerned about personal security,
- has buyers who have not been qualified by a real estate broker knock on his door at all hours of the day and night,

- finds the home-selling process is more complicated than he assumed,
- is not available during normal hours to show the home,
- does not understand the paperwork necessary to complete the sale and abide by local and federal laws,
- does not like negotiating with people, or
- is convinced that a buyer will reduce the price offered by at least the amount of the commission.

The broker-associate who has made a positive contact with the seller when those circumstances exist is most likely to get the listing. While the first item on the list is based on external conditions, the licensee may be able to change the seller's mind on the others during the listing presentation.

### ***Finding and Tracking FSBOs***

An important part of the FSBO prospecting process is finding and tracking FSBOs. Most sellers use a yard sign, a classified ad, a note on a community bulletin board, or an ad on a FSBO website.

The licensee may look for FSBOs in the local newspaper. The licensee may assume that all ads that don't have the name of a brokerage firm are FSBOs. A broker's ad that does not include the firm name is a blind ad, a violation of Real Estate Commission rules.

Because not all FSBOs advertise in the newspaper, the licensee can find those properties by driving through neighborhoods and asking friends and family to call when they see a sign or notice on a bulletin board or on the internet.

Even though this is the age of technology, many broker-associates keep index cards with the phone number prominently placed in the upper right corner of the card. You then sort the cards by the number. When going through the paper, look for the number, then compare it with the cards. If it's not there, this is a new property. See Figure 2.1 for an example of the file card system. To find the owners' information, use a cross-reference directory.

#### **Figure 2.1: FSBO Index Card**

Will Langston 2140 Birchwood Way Denver, CO 80218 Contacts: 4/15      Phoned. Said he did not want to list now. 4/20      Stopped by and gave him sample contracts. "Thanks!" 4/25      He got my "thanks" card. Called to ask me if I could give him an opinion of value. 4/26      Went over my CMA with him at the house. 4/27      He called me to come over and list his house at \$220,000.	(303) 555-4369
---	----------------

It's easier to sort the ads if the records are on your computer. A spreadsheet or a database program like Access makes it easier. Even your Word software makes it simple to sort using the table function (see Figure 2.2). Contact relationship management programs like *Top Producer* or *Act!* are specifically designed for this purpose, have many more functions, and are user-friendly. Your firm may have an in-house program for you to use to manage your contacts. Managing contacts and following up when promised are essential for your success.

**Figure 2.2: Sample Table for FSBO Information Sorted by Phone Number (If you're using a CRM, this will all be handled in the system. CRMs may prompt you when to call and follow up.)**

Phone	Name/Address	Price	Contacts
(303) 555-2527	Miguel Hernandez 1822 Third St. Denver, CO 80219	\$175,000	4/12 Phoned. Made listing appointment. 4/13 Got listing at \$175,000.
(303) 555-2421 <DO NOT CALL LIST!>	Mary Olsen 2507 Summer Ave. Denver, CO 80205	\$215,000	4/16 Stopped by. Told me she wasn't interested, but took sample contract.
(303) 555-4369	Will Langston 2140 Birchwood Way Denver, CO 80206	\$220,000	4/15 Phoned. Said he did not want to list now. 4/20 Stopped by and gave him sample contracts. "Thanks!" 4/25 He got my "thanks" card. Called to ask me if I could give him an opinion of value. 4/26 Went over my CMA with him at the house. 4/27 He called me to come over and list his house at \$220,000.

### ***FSBO Prospecting Techniques***

Licensees who work the FSBO market must be persistent, organized, and disciplined (POD). The first approach to a FSBO can be done by

- direct mail,
- telephone, or
- visit.

Direct mail is a low-risk technique that is likely to have a low reward ratio. Direct mail is **passive prospecting** and should always be followed by a phone call or a visit. When used in conjunction with one of the other methods, it can be an effective way to prospect. The objective of sending direct mail is to introduce you to the seller.

Before telephoning a FSBO, be certain that you understand and are complying with the National Do Not Call Registry. The liability for a violation of the law is quite substantial. If a FSBO's phone number is on the list, make a note such as <DO NOT CALL LIST> in all data so that the number is not accidentally called.

The objective for the call is to get an appointment to give a listing presentation (see Figure 2.3).

### **Figure 2.3: FSBO Telephone Calling Guide**

1. Check the National Do Not Call Registry before calling.
2. Introduce yourself and your company and say why you're calling.
3. Ask to visit the home at a specific time.
4. If the seller declines, you could ask if the seller would agree to pay a commission if you bring a buyer.
5. If the seller agrees to pay a commission, get an appointment to see the home.
6. If the seller doesn't agree, ask if he'd sell if the buyer agreed to pay the commission.
7. If the seller says no, ask if you can call again in the future.

The most effective way to get a listing is by visiting the house. Many licensees don't like to do this because of the risk of rejection. When you see a FSBO sign, just stop the car and walk to the door. You can also set up the visits by geographic area, using your FSBO data cards. Asking questions is the best approach. The objective for the visit is to get an appointment to give the seller a listing presentation (see Figure 2.4).

**Figure 2.4: So, You've Got a FSBO Appointment?**

If an owner accepts your request to visit, set the appointment for a time when all parties of record will be home and available to talk. Ask that the sellers have several items ready for you, if possible:

- A copy of the paperwork from when they purchased the property, especially the deed and title insurance documents
- Their homeowners insurance policy
- A copy of the property survey, if available
- An extra set of front door keys

Why do you need these items now?

- Because they will be helpful when you list the home
- Because when you get there and find all these items neatly stacked on the table, it's your signal that they are ready to list their home

***At the FSBO's Front Door***

Questions that may help you build rapport with the sellers include the following:

- How much are you asking for the home?
- How long has it been for sale?
- Are you moving out of town?
- Have you had any offers?
- If I brought a buyer to you, would you pay a commission?
- Do you have a sales contract?
- Would you like to see a market report on your neighborhood?

Don't forget that sellers are also buyers. You have to find out what they intend to buy, and where, when this house is sold. If the seller tells you they are moving to another city, you have an opportunity to send a referral to a broker in that area. Referral commissions can be a significant part of your annual income if you always get the information about where people are moving.

**For Rent by Owner**

The most common way to find **for rent by owners** (FRBOs) is by reading the classifieds in the newspaper or online. Owners who are trying to rent a house are good prospects for a listing, a sale, or property management.

***FRBO as a Listing Prospect***

Those who own rental homes experience difficulties such as vacancies, uncollectible rent, evictions, and damage to the property. When the home is currently for rent, the broker-associate must understand that some or all of those problems may have occurred very recently.

***FRBO as a Buying Prospect***

Sometimes investors have factored such problems into their business plan, understanding the characteristics of rental property. Those investors frequently plan to continue investing in rental property.

### ***FRBO as a Property Management Prospect***

Persons who have their property for rent may be weary of the time and effort involved in managing the property. They may have had difficulty showing the property because of other commitments, and sometimes rental prospects are no-shows. Your call may come at the right moment and may turn into an opportunity for management. If your company does not have a property management department, you can establish a relationship with a local company that will pay a referral fee for the business.

### ***FRBO Prospecting Techniques***

The first approach to a FRBO can be made by

- direct mail,
- telephone, or
- visit.

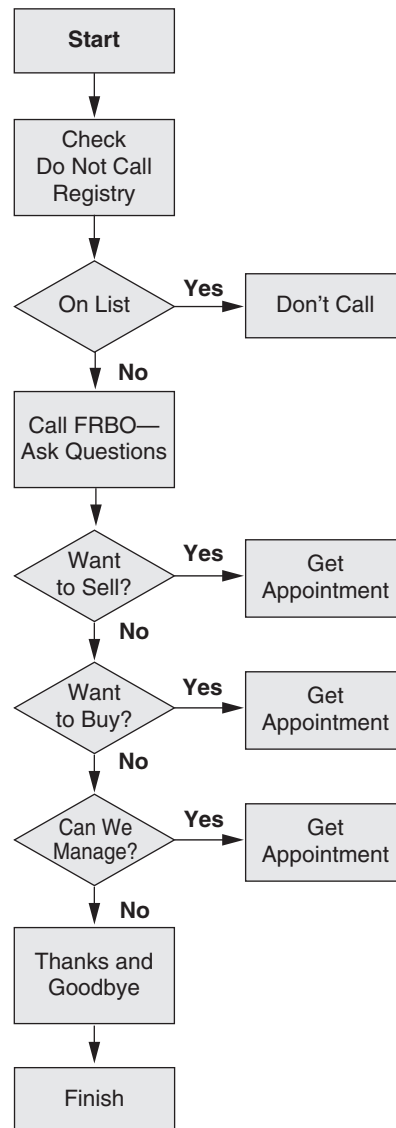
Because the phone number in the ad is that of the owner's home, not the rental, it's difficult to learn where the rental property is located. The first contact can be direct mail followed by a phone call. Before telephoning a FRBO, be certain to check the National Do Not Call Registry (see Figure 2.5).

#### **Figure 2.5: FRBO Telephone Calling Guide**

1. Check the National Do Not Call Registry before calling.
2. Introduce yourself and your company and say why you're calling.
3. Ask if the owner has considered selling rather than renting.
  - a. If the answer is yes, suggest you do a market report, and get an appointment.
  - b. If the answer is no, go to the next step.
4. Ask if the owner might consider buying other income property.
  - a. If the answer is yes, get an appointment to discuss other properties.
  - b. If the answer is no, go to the next step.
5. Ask if the owner has considered hiring a professional property manager.
  - a. If the answer is yes, get an appointment for your company's property manager.
  - b. If the answer is no, thank the owner for her time and say goodbye.

The objective of this call is to get an appointment to give a listing presentation. Remember, the advertised phone number matches the owner's address, not the rental property. See Figure 2.6 for an illustration of the possible business that can be generated from a call to an FRBO.

Another mailing, a phone call, or a visit should always follow direct mail. When used in connection with one of the other methods, it can be an effective way to prospect. The objective of sending direct mail is to get a call from the seller. Because the owner does not live at the rental property, visiting is probably the least effective method.

**Figure 2.6: Business Options From FRBO Call**

## Expired Listings

### ***Why Listings Expire***

Some listings don't sell during the listing period for a variety of reasons, including the following:

- Market conditions (oversupply of homes available for sale)
- Property condition
- Too short of a listing period
- Uncooperative owner or tenant
- Overpriced
- Poor marketing effort



Except for the uncooperative owner or tenant, the major reason listings expire is almost always price. If there is an oversupply of homes or the property doesn't sell in a reasonable time period, the price should be reduced. If the property condition is poor, the property is likely overpriced. A short listing period also calls for a low price.

### ***Finding Expired Listings***

Listings expire from the multiple listing service (MLS) every day. They are shown in the change-of-status section, where you can also find sales and price changes. Without the MLS, it is more difficult to work this market. An excellent way to find expired listings is to get a recommendation from a broker-associate who has a listing that is about to expire when the owner won't relist. You can either pay a referral fee or have a cooperative arrangement to send your sellers to them at the end of a listing period.

### ***How to Approach the Owners of Expired Listings***

The owner whose property did not sell may be disillusioned with brokers and unreceptive to your approach. To effectively work expired listings, you must have empathy. The seller whose home was on the market for six months and didn't sell might

- wonder why she bought a home that no one else likes,
- feel the broker did little or nothing to market the property, or
- believe the home was overpriced during the listing period.

Once you understand how the owner might feel, you will be better able to tailor your approach to the situation.

Licensees can prospect for expired listings using the following methods, which may be used with FSBOs or FRBOs:

- Direct mail
- Telephone
- Visit

Direct mail may be ineffective because owners who want to sell often list with another broker immediately after the listing expires. A visit may not be as time-effective as telephoning, but visiting the owner is more likely to result in getting the listing. When the owner answers the door, you might ask the questions in the telephone calling guide in Figure 2.7. Your objective is to be invited inside to view the home, getting an opportunity for a listing presentation.

### **Figure 2.7: Expired Listing Telephone Calling Guide**

1. Check your MLS to make sure they haven't already listed with another firm.
2. Check the National Do Not Call Registry before calling.
3. Introduce yourself and your company and say why you're calling.
4. Tell the seller the listing has expired and ask if the seller still wants to sell.
  - a. If the answer is yes, get an appointment.
  - b. If the answer is no, ask if the seller would like to know why the house didn't sell. Get an appointment, and make a CMA study.
  - c. If the answer is no, thank the seller and place another call.

## Farming

Think of farming as the cultivation of listings, much like establishing an orange grove. You can't get rich planting one tree. The more trees you plant, the greater the harvest. The grove takes a lot of work for some time without any apparent return. But when the grove begins to produce, it can shower you with fruit for years to come. And as the trees grow larger, the size of the harvest increases and can make you rich.

A listing **farm** requires lots of hard work to get established and for a time may have no apparent return. Many listing farmers abandon the grove just before it produces. If you decide to farm an area, you must make a commitment to continue for at least three years.

### What's the Payoff?

Farming is a disciplined approach to prospecting. It is intended to expand a broker-associate's sphere of influence, thus increasing listings and sales. Joyce Caughman's book *Real Estate Prospecting: Strategies for Farming Your Markets*, 2nd edition (Dearborn Real Estate Education, 1994) describes how farming should produce 20% of the listings in the farm area in the second year, 50% in the third year, and up to 75% of the listings after that. There are many other books available to help you with farming a neighborhood.

Assume that owners in your farm area move once every six years and your farm has 800 houses. That means 133 homes will be listed this year ( $800 \div 6$ ). If you're in the third year of your farm and get 50% of those listings, you'll get 67 listings, or  $5\frac{1}{2}$  each month. Assuming further that the average sales price is \$200,000, two-thirds of your listings sell, and your share is 1.5%, your listing commissions alone would be over \$134,000 ( $\$200,000 \times 67 \times \frac{2}{3} \times 0.015$ ).

### How Many Homes Should Be in a Farm?

Because it may take six months before the farm begins generating listings, a broker-associate must also prospect using other methods. A new licensee should start a farm with no more than 200 homes but should select an area that allows for expansion of the farm. Many successful broker-associates ultimately develop farms with 800 to 1,000 homes in several neighborhoods.

### How to Choose the Farm Area

You must carefully select your listing farm. It should have the following characteristics:

- Middle to upper price range
- High turnover
- Increasing property values
- Not currently being farmed by any other broker-associate

The steps to take in beginning a farm area are the following:

1. Select at least six potential farm neighborhoods. Check the MLS or the tax appraiser's office for all sales during the previous year.
2. Of those sales, review the listing office and broker-associate so you can see if one person is getting a large market share. This would indicate that person is farming the area.

3. Determine the total number of homes in the area by looking at the subdivision plat map available on county websites.
4. Divide the number of sales by the number of homes in the neighborhood to get the turnover index.
5. Select the neighborhood that is not currently being farmed that has the highest turnover index.

Figure 2.8 is an example of the evaluation process. Blackwater Farms and Green Valley are currently being farmed, so it's not worthwhile to try to compete if other good areas are available. Mountain View has a 25% turnover ratio, and the home prices are in the \$200,000 range. Mountain View is the best choice for farming.

**Figure 2.8: Farm Area Evaluation**

Neighborhood	Currently Farmed?	Home Prices	Sales Last Year	Homes in Neighborhood	Turnover Index
Rustling Woods	No	\$175,000	88	521	17%
Blackwater Farms	Yes	\$200,000	86	416	21%
North Gate	No	\$150,000	145	740	20%
Cold Springs	No	\$250,000	52	345	15%
Mountain View	No	\$200,000	172	685	25%
Green Valley	Yes	\$250,000	68	534	13%

### ***Make Contacts Now, Organize Over Time***

Some broker-associates spend too much time preparing to farm and too little time making contacts. While it's nice to have a map wall, a database of information about each homeowner, or prepared mailings for the next six months, that can be done later. It's tempting to "play office" rather than take the risk of talking with prospective sellers.

One task that you should do up front, however, is prepare a market report for the neighborhood, showing listings and sales for at least three years. This will help you discuss prices and learn what prospective sellers paid when they purchased.

### ***Making Contacts in Your Farm Area***

Contacts in your farm area should be a combination of direct mail, telephone, and a visit. Remember, direct mail is passive prospecting that works well if personal contact is also part of the farming program. A color newsletter with your name and company logo is inexpensive and can result in more business. You can also send a letter of introduction, a postcard, or any other mailing piece that keeps your name in front of owners. Notices of listings and sales in the farm area can be one of the most effective and cost-efficient mailings, but these should be followed by a phone call or a visit (see Figure 2.9).

**Figure 2.9: Notice of Sale Card**

Calling people in a farm area can be effective, but there should be a good reason for the call. Some reasons include telling owners about a new listing or sale or that you will be holding an open house in the area.

The best way to cultivate your farm is by visiting owners in the neighborhood. Saturday is a wonderful visit day. A drive through the neighborhood allows you to stop and meet people who are out walking or doing yard work.

Of course, just knocking on doors is one of the best activities. Give the homeowner a gift, such as a calendar or yardstick with your name (and company name) imprinted on it, or a report showing the recent activity in the area. Most MLS systems make this easy to do, and the reports generated will be branded with your contact information. The owners will remember you when it's time to sell their homes.

You should make at least one contact each month with everyone in your farm area. It's a good idea to start with a small area and expand later. The most important thing is that you must be consistent. You must contact homeowners consistently if you want them to remember you. Doing irregular prospecting doesn't work. Providing them with a monthly printed neighborhood report is a good way to do that. If you start in a larger area and farm 500 homes and if you work 25 days each month, you must make at least 20 contacts each day. Rotating between mailings, phone, and visits may reduce your workload. After you become well-known, you can increase the mail contacts and reduce the personal contacts.

## Canvassing

Canvassing is prospecting by mail, by telephone, and in person, not necessarily in your farm. All **power prospecting** programs include canvassing. The Daily 100 prospecting chart on pages 359–360 is a good reminder list.

Every broker-associate who aspires to attain top-producer status understands the power of canvassing. While this is the last prospecting tool mentioned as a listing source, it is likely the most important.

## BECOMING A LISTING SUPERSTAR

This section is designed for broker-associates who are not satisfied with a median net income, but who want to be in the 90th percentile and above. The average licensee does prospecting inconsistently and in small numbers and the results are modest. The superstar prospects to a huge base of leads and harvests huge rewards. You should go back to your goals worksheet and kick it up a notch! Fill out the worksheet to determine how to make a gross income of \$200,000.

### Your Leads Database

First, set up a software database. There are many databases available, including MS Excel and Top Producer. Your firm may have one you can use. One of the first steps is to organize your potential leads into five database categories:

- Friends and family
- Other friends and acquaintances
- Past clients
- Targeted strangers

You need the different categories because your prospecting methods depend on your relationship.

There is another category of persons, called *others*, who won't be put in your database. They make up the general population—strangers whom we don't consider prospects.

### Close Friends and Family

This category of leads will be very small, with probably no more than 30 to 50 names. Close friends and members of your family will do business with you and send you referrals, but you may need to ask. The term *close friend* suggests a very strong, usually long-term relationship with mutual trust, care, and respect. Sometimes even close friends are reluctant to do business with friends for fear that the relationship could be affected. Your friends must be convinced of your professionalism and dedication. You must let them know that when you do business you will wear your “professional” hat. The contacts within this group are natural and frequent, and all requests for business should be low-key.

### Friends and Past Clients

These are people we know reasonably well but who are not close friends. Perhaps we have had lunch together or worked on a committee together. We should be working hard to move more people to this list from the list of acquaintances and targeted strangers. The size of this category will grow with the number of years you are in real estate. This group is a significant source of new business and referrals. Work it diligently! Each person on the list should hear from you by mail or phone at least twice monthly.

## Acquaintances

These are people we've met or spoken to in person or by phone but don't yet know well. We will develop this group into a powerhouse of direct and referral business. One of the major objectives of our prospecting efforts is to move as many targeted strangers to the acquaintance or close friends category as possible. We should have a combination of contacts with this group using mail and telephone at least two times per month.

## Targeted Strangers

**Targeted strangers** are people we don't know who are qualified by income, occupation, or residence address. This is by far the largest group in your database. The names might come from mailing list companies based on income levels, from cross-reference directories, or from lists of doctors, attorneys, accountants, and business owners. This list should be very large, starting with at least 5,000 names and addresses. In the beginning, you should send a direct mail piece (it could be a postcard or newsletter) at least six times annually. Leads that are generated must be followed up immediately. If you generate one transaction for every 100 names (a modest goal), you will have an additional 50 transactions this year. If your average commission is \$2,000 per sale, your income has increased by \$100,000.

## What Will It Cost?

Postcards can be designed online through companies like Vistaprint using one of hundreds of templates. Many firms have postcards already designed for use by their associates. Five thousand glossy finish postcards, printed front and back, cost about \$400 plus shipping. You can upload your photo and company logo. Send a different postcard each month. Your software will make label printing easy. Let's check the numbers:

Estimated gross income	\$100,000
Less prospecting costs	
Postcards	
\$399 (for 5,000) for 12 months ( $12 \times \$399$ )	\$4,788
Estimated mailing costs	\$612
Postage	
60,000 cards $\times$ 0.26	\$15,600
Labor	
6 hours $\times$ \$8 per hour $\times$ 12 months	\$576
Total costs	<u>\$21,576</u>
<b>Net income generated</b>	<b>\$78,424</b>

## Making Contacts

Some important points to remember when prospecting include the following:

1. Success is in the numbers

Be confident that this process will result in much higher income levels. You will discover that there is a strong correlation between your prospecting and the number of transactions you make. When you discover what your personal ratios are, it's easy to better control your income levels through your daily prospecting. If you get \$3,000 extra income, on

average, from every 100 contacts you make, you should assume that by making 1,000 additional contacts (20 per week) you can increase your income by \$30,000.

2. Be consistent

Set the same time every day to make your contacts. Stick to the schedule, but if a closing or appointment conflicts, make sure your contact time is rescheduled for later in the day. It's like a diet: you might get off track, but success will come if you get back to the plan.

3. Call at your best time of day

Some people are great in the morning. Others are a little grumpy and should set their prospecting time later. Just be sure you have a high energy level when making contacts. Morning may be the best time for a prospecting routine because showing and listing appointments are usually set for afternoons or evenings.

4. Plan what you're going to say

Always include asking them if they plan to buy or sell in the near future or if they know someone who is. If you get a yes, immediately schedule the appointment. Free scripts are available on the internet.

5. Make the first call

The rest will be easier. Think of the athletic slogan "Just do it!" The hardest call is the first call. Just think one call at a time.

6. You'll get better

As you make your daily calls, your contact skills will get better and your enthusiasm levels will increase.

7. Remember the goal

Before you make your calls, visualize what you want to happen as a result of the call. Put a sign above the phone that says, "Get an appointment!" Another sign might read "Get a referral!"

## Saturate and Remind

When you put a new entry into your acquaintances category, your strategy should be to saturate and remind.

If you watch television, you have undoubtedly seen one or more companies start a major media campaign with saturation broadcasting. A three-hour sports program, for example, might have as many as ten 30-second commercials in the first two hours. For the next hour, the commercial is often abbreviated to 15 seconds, but we know it well enough so that the short ad is as effective as the longer one. This is saturate and remind.

When you meet a new qualified prospect by phone or in person, that person is now put in the saturate mode, with at least a weekly contact for six weeks. Now they know who you are and what you do. If your contacts have been skillful, they also like you, will do business with you, and will send you referrals.

After the saturation period, you can reduce the number of contacts to twice monthly, and you'll have a steady source of business.



## SUMMARY

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The main objective of a licensee when prospecting is to get an appointment. The most important sources of listings for new broker-associates are for sale by owners, for rent by owners, expired listings, farms, and canvassing. If someone you contact is interested, ask for the appointment right then by saying, “Does Saturday morning at 10 am work for you? Or is Sunday at noon better?”

You should be selective about which listings to try to obtain and avoid listing property if the seller is not motivated or wants you to break the law. Also avoid listings that are out of your market area or are in poor condition.

Licensees who work the FSBO market must be persistent, organized, and disciplined (POD). Most FSBOs try to sell direct to save the commission, and most advertise in the classifieds and on online FSBO sites. The most effective way to get a listing from a FSBO is to pay a visit. Organize the FSBOs by telephone number.

A broker-associate who prospects for rent by owners has a chance of three types of transactions: the FRBO might list the house, buy another house, or ask the licensee to manage the property.

Farming is a prospecting activity with long-term results. A broker-associate who farms an area for several years may get up to 75% of the listings in each neighborhood. The farm should be in a large area, but the associate should start with no more than 200 houses. The farm should be in a high-turnover neighborhood that is not currently being farmed.

Canvassing is the process of contacting prospective customers by mail, by telephone, or in person. Licensees who want to engage in power prospecting must establish a contact database containing close friends and family, friends and past clients, acquaintances, and targeted strangers. Friends, past customers, and acquaintances should be contacted in some way at least twice monthly. For new people in the acquaintances category, you should have a contact program called saturate and remind, meaning weekly contacts for at least six weeks, then contacting each person twice monthly. You can use a CRM to help automate this process and remind you when to follow up.



# UNIT 3

## Pricing the Property to Sell

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Explain the difference between an appraisal and an opinion of value.
- › List four conditions that must be met in order to fairly use a comparable sale.
- › List the three categories of properties shown in a CMA.
- › List at least three sources of information used in compiling a CMA.
- › Explain the adjustment process and direction of the adjustment.

### KEY TERMS

adjustments  
appraisal  
comparable property

comparative market  
analysis (CMA)  
opinion of value  
property characteristic

reconciliation  
subject property  
transactional characteristic

### OVERVIEW

Two duties owed to the public by real estate brokers are care and diligence. Assisting a seller in setting a realistic listing price or helping a buyer understand the market and assisting in setting a realistic offering price are two of the most important services a broker-associate can offer.

Because all real estate activity is related to value, a valid estimate of property value has a significant effect on marketing a listing.

*Market value* is the most important value in a real estate transaction. The market value of real estate is the most probable price a property should bring in an arm's-length transaction occurring in a competitive and open market.

Real estate licensees use the process of sales comparison to produce opinions of value called comparative market analyses (CMAs). Your local MLS may have an automated process for preparing a CMA. Note that a real estate licensee may not call their CMA an appraisal unless the licensee is also a licensed real estate appraiser.

Licensees must be familiar with the valuation of real property. While licensees do not prepare formal real estate appraisals, they will go through the appraisal process to some degree when listing properties. Licensees must have a good working knowledge of the market in which they operate to be able to use evaluation methods competently.

## OPINION OF VALUE VS. CERTIFIED APPRAISAL

Real estate licensees may not refer to themselves as appraisers unless they are licensed appraisers. Licensees may be paid for providing **opinions of value** or comparative market analysis (CMA) services as long as they do not represent themselves as certified appraisers or their reports as certified appraisals. This unit focuses primarily on preparing opinions of value.

Remember, the Real Estate Commission states:

When a real estate licensee prepares a comparative market analysis (CMA) for any reason other than the anticipated sale or purchase of the property, the licensee must include a notice stating: “The preparer of this evaluation is not registered, licensed, or certified as a real estate appraiser in the state of Colorado.”

### Basic Principles of Value

Many economic principles influence the value of real property. They are interrelated, and their relative importance varies depending on local conditions. The following principles are important to licensees attempting to estimate market value:

- Substitution
- Highest and best use
- Law of supply and demand
- Conformity
- Contribution
- Law of increasing and diminishing returns
- Competition
- Change
- Anticipation

### Substitution

Substitution is probably the most important factor in pricing residential property in a neighborhood with an active market. The value of a given parcel of real property is determined using the principle of substitution. The maximum worth of the real estate is influenced by the cost of acquiring a substitute or comparable property.



#### FOR EXAMPLE

You have prepared a CMA for Savannah Cooley. Your opinion of value, based on sales of comparable homes, falls in a range between \$192,000 and \$203,000. Savannah needs \$215,000 from the sale of her home to pay a number of obligations and requests that you list it at that price. Give four persuasive arguments for listing her property at market value.

### ***Highest and Best Use***

Highest and best use of the real estate is only used by an appraiser. When a licensee prepares a residential CMA, they do not consider a property's highest and best use. A licensee's CMA is to determine the property's current market value.

### ***Law of Supply and Demand***

As it does with any marketable commodity, the law of supply and demand affects real estate. Property values rise as demand increases or supply decreases. For example, when interest rates declined recently, demand for residential property increased significantly, resulting in dramatic increases in prices throughout most of Colorado.

### ***Conformity***

In neighborhoods of single-family houses, buildings normally should follow the principle of conformity; that is, they should be similar in design, construction, and age to other buildings in the neighborhood to realize their maximum value. An elaborate mansion on a large lot with a spacious lawn is worth more in a neighborhood of similar homes than it would be in a neighborhood of more modest homes on smaller lots. Subdivision restrictive covenants are designed to promote the principle of conformity to maintain and enhance values.

### ***Contribution***

Any improvement to a property, whether to vacant land or a building, is worth only what it adds to the property's market value. An improvement's contribution to the value of the entire property may be greater or smaller than its cost. A licensee's opinion should be governed by a feature's contribution to value, not its actual cost.



#### **FOR EXAMPLE**

You have prepared a CMA for Phyllis, who lives in Scenic Heights, an area of \$200,000 homes. Phyllis reviews the recent sales and sees that her house has a large deck and hot tub, a feature that is not present in the homes in the report. She produces the invoices for the cost of her deck and hot tub, which total \$15,000, and suggests a \$215,000 list price. You believe that decks and hot tubs in the neighborhood add about \$5,000 to the properties' list prices.

Do a role-playing exercise, with another person taking Phyllis's part, and discuss the principles involved.

### ***Law of Increasing and Diminishing Returns***

Improvements to land and structures reach a point at which they have no positive effect on property values. As long as money spent on such improvements produces a proportionate increase in income or value, the law of increasing returns is in effect. When additional improvements bring no corresponding increase in income or value, one can observe the law of diminishing returns.

Smaller homes in a neighborhood of larger homes may experience increasing returns by improvement. Homes that are the same size as or larger than surrounding homes should not be improved significantly until the owners have considered the economics of their decisions.

**FOR EXAMPLE**

Karina Lee purchased a two-bedroom home in Betton Hills for \$200,000. She builds an extra bedroom and bath and finds that the value has increased by much more than the cost of the improvements. She continues improving the property by adding two more bedrooms and a large family room with a fireplace. Karina decides to sell, and she calls you to list the property. Your CMA shows that the value increase was much less than the construction cost. Karina disagrees with your findings.

Do a role-playing exercise, with another person playing the part of Karina, while you explain to her why the value may not have increased as much as the cost of the improvements.

**Competition**

All residential properties are susceptible to competition, some more than others. The only house for sale in a nice, well-maintained neighborhood has a better chance of selling at or near market value than if several houses on the same street are for sale.

**Change**

All property is influenced by the principle of change. No physical or economic condition remains constant. Licensees must be aware of market forces when preparing opinions of value.

**Anticipation**

Most buyers purchase real estate with the expectation that its value will increase—and they are rewarded when the anticipation proves correct. In inflationary times, the anticipation of higher prices creates a multitude of buyers, driving prices higher than can be supported for long periods. In Colorado, the prices for mountain properties have increased dramatically, especially if they are in or near a ski resort area.

But when the market begins to top out, the anticipation of a price recession can cause investors to dump property on the market, increasing inventory levels and forcing prices lower. Anticipation also is important to prices of property in times of decreasing interest rates, when builders rush to fill the expected demand. Licensees must be aware of the importance of anticipation when valuing property for sale.

**COMPARATIVE MARKET ANALYSIS**

Most licensees use a **comparative market analysis (CMA)** to arrive at an opinion of value. A CMA is the process of gathering and analyzing the **property characteristics** of homes currently for sale, homes recently sold, and homes listed that did not sell. It may range in form from a simple list of recent sales with no adjustments to a detailed adjustment grid. Whether taking a simple or a complex approach, a licensee needs to ensure that all of the conditions for selecting comparables have been met.

**Gathering CMA Data**

First, the broker-associate must have knowledge of the **subject property**. If it is a subdivision home with a standard floor plan, it may be possible to complete a market analysis without a property inspection. However, if the seller has made many improvements or if the home has other amenities that are not typical of the market, it may be difficult to make adjustments

during the CMA's presentation phase. The truly professional approach is to inspect the property before completing the CMA.

Once the property inspection has been completed, the licensee should select the best properties for comparison. Three categories of comparison help sellers and buyers better understand the market:

- Properties that have sold
- Properties that are now on the market
- Property listings that have expired

The CMA will be a good indication of value only when comparables exist in a reasonably active market and where sufficient, reliable market sales information is available.

A **comparable property** should meet four conditions before it is used in a CMA:

- It should be similar to the subject property.
- If this is a sale, it should have sold recently (within the past year).
- It should be located in the same market area as the subject property.
- It should have changed owners as a result of an arm's-length transaction.

Reviewing the actual sales prices of comparable properties helps buyers and sellers see what buyers actually pay in the marketplace. Comparable sales data is important when new financing is necessary because an appraiser relies on this data to estimate market value. Many sales are contingent on financing the purchase price, so it is of no value to overprice a property only to lose the sale when the lender and buyer receive the appraisal report.

Reviewing the prices of comparable properties now on the market shows the seller what owners of properties with similar characteristics are asking. These are the properties that will compete with the seller's. The principle of substitution means that a buyer will select the property with the best price, all other things being equal. A seller who wishes to position the property in the most effective price window values it just above recent sales and just below competing properties. A properly priced listing should experience a reasonably quick sale at the optimum price.

The listing prices of properties that do not sell tell a great deal about the resistance level of buyers to overpriced listings. In almost every case, the expired listing has been priced too high for the amenities offered.

The best sources for gathering CMA information include

- multiple listing service (MLS) records,
- company files,
- public records,
- other licensees, and
- data service companies.

MLS records are the most convenient and comprehensive method of getting listings and sales information. MLS computer records can be searched by address and subdivision for ease in finding comparable sales. The information can be retrieved for sold, current, or expired property listings.

Company files are limited in scope but may be more complete as to property descriptions and financing used in purchases.

Public records include information recorded in the clerk's office and information on file with the tax appraiser. Except for verification of sales data and identities of the parties, the information from the clerk's office is not as important as the information available at the tax appraiser's office. While the information from the property appraiser's records is sometimes outdated, the records are still a useful source of data. Because the sold section of the CMA should include for-sale-by-owner properties, the appraiser's office is often the best information source for such sales.

Licensees often know of properties that have just closed. The information given should be verified and added to the report to include current sales.

Data service companies compile property sales data and sell the information to interested parties. This information does not give complete property descriptions and is best used as a checklist to ensure that all sales have been considered.

## Selecting Comparable Properties

A licensee preparing a CMA has two choices when selecting properties to compare. The first is to report every sale and every listing in the neighborhood, together with features and prices. The other is to analyze only the properties that are comparable.

Reporting all properties gives the seller an overview of the entire neighborhood market. Some sellers believe a list is incomplete if they know of a neighbor's home that sold recently that is not on the list; therefore, a complete list may make sellers more comfortable. However, problems sometimes arise with this all-inclusive list. Properties that are not comparable may mislead a seller concerning values. Properties that should not be used as comparables when making CMA adjustments include those that have significant differences in construction quality or size. Properties sold to relatives may be suspect as to fair value of the price and should be excluded from consideration.

Listing only three or four comparable properties makes a clearer presentation for a seller and reduces the chance for confusion about values. This is the approach appraisers use.

Perhaps the best approach for the licensee is to prepare a comprehensive list of all properties that have sold, are listed currently, or have expired and then select the most comparable properties from that list for analysis. This method satisfies the needs of completeness and clarity.

## Common Elements of Comparison

Clearly, the accuracy of the comparable sales approach relies on the elements of comparison selected for adjustment. The elements listed in the CMA chart in Figure 3.1 are some of the most common and significant factors that affect value in standard residential appraisals. In any given analysis, it may be necessary to include other adjustments. The easiest way to fill out the CMA is to list all of the details of the subject property, then evaluate each comparable with the data that has been gathered.

Figure 3.1: Sample Property Characteristics

Location	Number of rooms
Size and shape of the lot	Number of bedrooms
Landscaping	Number of bathrooms
Style	Kitchen characteristics
Construction quality	Condition of the exterior
Design	Condition of the interior
Age	Garage
Square feet of gross living area	Other improvements

These are selected examples only; more or fewer characteristics may be applicable.

Location

What are the three most important determinants of property value? The old expression “location, location, location” is the best answer. Location is so important that only in very unusual circumstances would a licensee use a property outside the subject’s neighborhood as a comparable sale. In such a case, the comparable should come from a similar neighborhood. Even within the same neighborhood, locations can result in significant variances. A property across the street from a park is more valuable than one across the street from a commercial area.



FOR EXAMPLE

Sara Bilina wants a for sale by owner to list with her, but the FSBO says that the commission added to his price would make the property overpriced. Sara really wants the listing, so she finds several homes that are the same size as the FSBO’s property and prepares a CMA. However, the comparables she uses are located in another, more upscale neighborhood. The owner looks at the CMA and lists with Sara.

Has Sara prepared an acceptable CMA? Why or why not?

Has Sara violated any ethical or legal code? Why or why not?

Size and Shape of the Lot

Irregularities can make portions of a site unusable for building, impair privacy, or restrict on-site parking, which could require major adjustments. Street frontage and total square footage are other important considerations.

Landscaping

Trees, plantings, and other types of landscaping should be evaluated as to maturity, quantity, and quality.

Construction Quality

If the construction quality of a comparable is not equivalent to that of the subject property, a major adjustment must be made. It is possible that the difference in quality might disqualify the property as a comparable.

## **Style**

Generally, the style of a house follows the rule of conformity (a house should not be the only one of its type in the neighborhood). An important aspect of style is the number of floors of the residence. A one-story ranch house probably could be compared to a split-level, with some adjustments made. However, a three-story house is not comparable to a one-story ranch house. The best comparison is always a ranch to a ranch, a two-story to a two-story, and so on.

## **Design**

Design must be viewed from both functional and aesthetic standpoints. Functional aspects include the existing traffic patterns in the house, the placement of doors and windows, room-to-room relationships, and the usefulness of the rooms. Aesthetic aspects focus on how pleasant and attractive an interior appears to an observer.

## **Age**

Because most subdivisions are built within a relatively short time, there may not be significant age differences among comparables. A brand-new home is likely valued by the builder according to actual costs, overhead, and profit. While overall upkeep is important, the home's age may alert the licensee to outmoded design and fixtures or needed repairs.

## **Square Feet of Gross Living Area**

The square footage of the home is one of the most important areas of consideration. Often within a subdivision or neighborhood, similar square footage in homes is common. Use the homes that are similar in square footage first to avoid making adjustments because size differences among homes can be calculated easily. If licensees make adjustments for square footage, they also must be careful when adjusting for the number of rooms or bedrooms, as this could lead to double counting. Adjustments for gross living area can be misleading if not all properties are comparable. For instance, a small house normally sells for more per square foot than a large house in the same area. A one-story house has a higher cost per square foot than a two-story house. Be sure that all properties used are comparable to the subject property. Appraisers normally do not count any floor area that is below grade as gross living area, so do not use such properties unless the subject also has below grade area.





**FOR EXAMPLE**

Silas Dean is trying to set a price for a 1,500-square-foot home in Green Hills. He finds the following comparable sales:

Price (\$)	Square Feet	Price per Square Foot (\$)
49,500	980	50.51
51,000	1,025	49.76
50,000	1,000	50.00
61,500	1,500	41.00

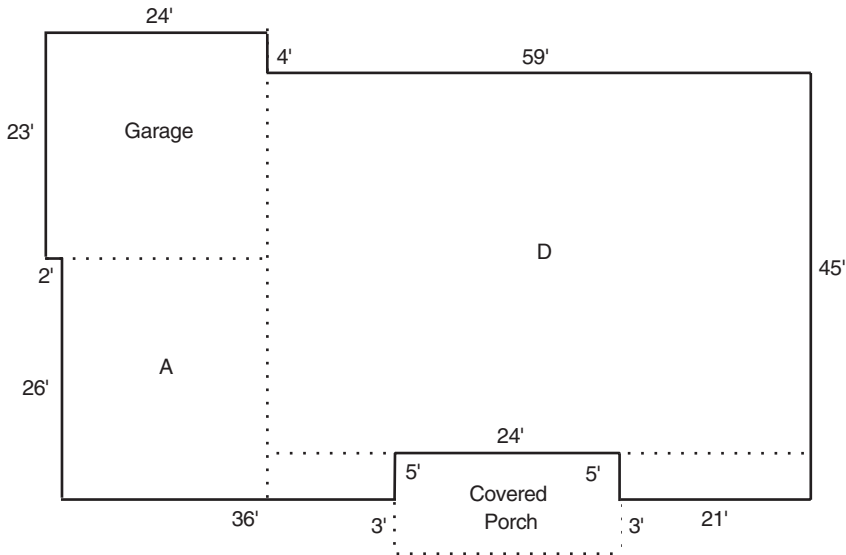
The average price per square foot for these properties is \$47.82. Ana Williamson, who owns the home, asks, “What is it worth?” Silas replies, “Houses sell for \$47.82 per square foot in this neighborhood. Based on that, your property should sell for about \$71,700.” Ana agrees and lists at \$71,500.

Do you agree with Silas’s analysis? If not, why not?

**Measuring Practice**

Measurement of a house is extremely important. An error could cause problems in pricing the property if the home’s square footage is given to buyers. Calculate the square footage of gross living area of the house shown in Figure 3.2.

**Figure 3.2: Living Area Outline**





### FOR EXAMPLE

You have done a market report for the Meadows at Woodrun subdivision. Your analysis of property value, based on several 1,200-square-foot homes, indicates that homes sell at prices averaging \$50 per square foot. When talking by phone with a prospective seller, you quote that figure after setting the listing appointment. When you arrive at the property with your listing information in hand, the seller proudly shows you the 500-square-foot two-car garage that has been converted into a heated and cooled family room. He indicates that the price at which you should list the home is \$85,000, based on 1,700 square feet times your \$50-per-square-foot figure. Role play this situation and explain why it may be difficult to market this home at \$85,000. Also determine some methods of arriving at a more realistic price.

### ***Number of Rooms***

The total number of rooms in a house does not include the foyer or bathrooms and generally does not include basement rooms. Don't double count when adjusting for square feet and number of bedrooms.

### ***Number of Bedrooms***

A major adjustment is needed if the subject property has two bedrooms and the comparables have at least three, or vice versa. Don't double count when adjusting for square feet.

### ***Number of Baths***

This category comprises full baths (lavatory, toilet, and tub, with or without shower), three-quarter baths (lavatory, toilet, and shower), and half baths (lavatory and toilet). Modern plumbing is assumed, so an adjustment must be made for out-of-date fixtures if different from the subject property.

### ***Kitchen***

Licenses should focus on the following key factors:

- Location
- Counter space and storage
- Service triangle
- Appliances

The location of the kitchen is an important factor, based on its convenience to dining areas and accessibility for unloading groceries. The market will not accept a kitchen with inadequate counter and storage space. The service triangle is calculated by drawing straight lines connecting the refrigerator, range, and sink. Most consumer polls show that the total length of the three lines should be greater than 12 feet but should not exceed 22 feet. Appliances represent a sizable portion of the home's cost, and their age and condition are important.

***Other Space***

An unfinished attic, a porch, a utility room, an enclosed sun porch, or any other room that is not part of the primary house area is included in this category. If a room is not heated it is typically not included in the gross square footage.

***Condition of the Exterior***

An adjustment should be made for any needed repair work.

***Condition of the Interior***

An adjustment should be made for needed repairs. Luxurious finishing, such as real wood paneling, adds to a home's value.

***Garage***

If the subject does not have one, any garage on a comparable property requires an adjustment. Garages on the subject and comparable properties must be compared for type of construction and size.

***Other Improvements***

An adjustment should be made for differences between the subject property and the comparable. Landscaping, driveways, trees, and views should be adjusted based on their contribution to value.

***Adjusting for Differences***

Ideally, the licensee wants to find comparable sales that are identical in characteristics to the subject property. In the real world, this doesn't always happen. While the CMA is not meant to be an appraisal, it is necessary to adjust for some of the differences discussed earlier. A major difference between the subject property and the comparable property, such as a new kitchen, could make an opinion of value very misleading if no adjustment is made for the new kitchen. Many licensees recognize the difficulty in conducting a CMA because when they look at a sold property, they see it as it is *today*, not how it looked when it went under contract. The important consideration in adjusting the comparable sale is how it looked at the time of sale.



### FOR EXAMPLE

Whitney Cooley, a licensed broker-associate, is preparing a CMA for Brian Edwards's three-bedroom, two-bath home in Eastgate. A comparable property with the same floor plan sold recently for \$73,000. The only difference between the properties is that the comparable property has an updated kitchen. Whitney has done CMAs in Eastgate before and estimates that an updated kitchen contributes about \$4,000 to value. The subject property doesn't have an updated kitchen, so Whitney makes a minus adjustment of \$4,000 to the comparable's sales price. This indicates a value of \$69,000 for the subject.

How did Whitney determine that an updated kitchen contributes \$4,000 to value in that neighborhood? The matched pair technique helped her make the estimate. She examined two recent sales in which the only difference was the fact that one property had an updated kitchen. The property with the newer kitchen sold for \$4,000 more than the home without the update. Because the kitchen was the only difference, the \$4,000 must be attributable to that amenity. It would be better to make the comparison with several matched pairs to support the conclusion, but the technique is valid. The cost to update the kitchen is not added, just the value buyers and sellers place on the newer kitchen.

Adjustments are always made to the comparable property, never to the subject. Adjustments are subtracted from the comparable property if the comparable is bigger or better. Adjustments are added if the comparable is smaller or less desirable. An easy way to remember this is "CIA, CBS":

- If the comparable is inferior, add.
- If the comparable is better, subtract.

Adjustments should be made for sold properties, listed properties, and expired properties; then, each category should be reconciled.

## Reconciliation

**Reconciliation** is the resolution of several adjusted values on CMAs into a single estimate of value. While an appraiser is expected to report a single market value amount, a licensee making an opinion of value may prefer to report a range of values, from the lowest to the highest adjusted value of the comparables. Presenting a range rather than a single estimate of value allows a seller to price the property somewhat higher than the sold properties would indicate. The seller should understand that the home will likely sell at some price other than the list price and should consider all offers within the range of values.

Reconciliation enables the licensee to set the range differently. The first step is to estimate the value for each section of the report (sold properties, listed properties, and expired listings). Reconciliation is not simply the averaging of these values. The process requires the licensee to carefully examine the similarity of each comparable property to the subject property. If one comparable is nearly identical to the subject, including all relevant **transactional characteristics**, the sales price of that comparable might be the subject's estimated market value. When the comparables vary in their degree of similarity to the subject, the comparable property that is judged most similar is assigned the greatest weight in the reconciliation process.

The estimates for each section are rounded. The range is then calculated from the reconciled value of the sold properties and the reconciled value of the properties listed currently.

Another method for setting a range of values is to reconcile the sold properties to a value estimate, check to see what properties sell for as a percentage of the list price, and then divide the value estimate by that amount. The two values become the highest and lowest values in the range.

**FOR EXAMPLE**

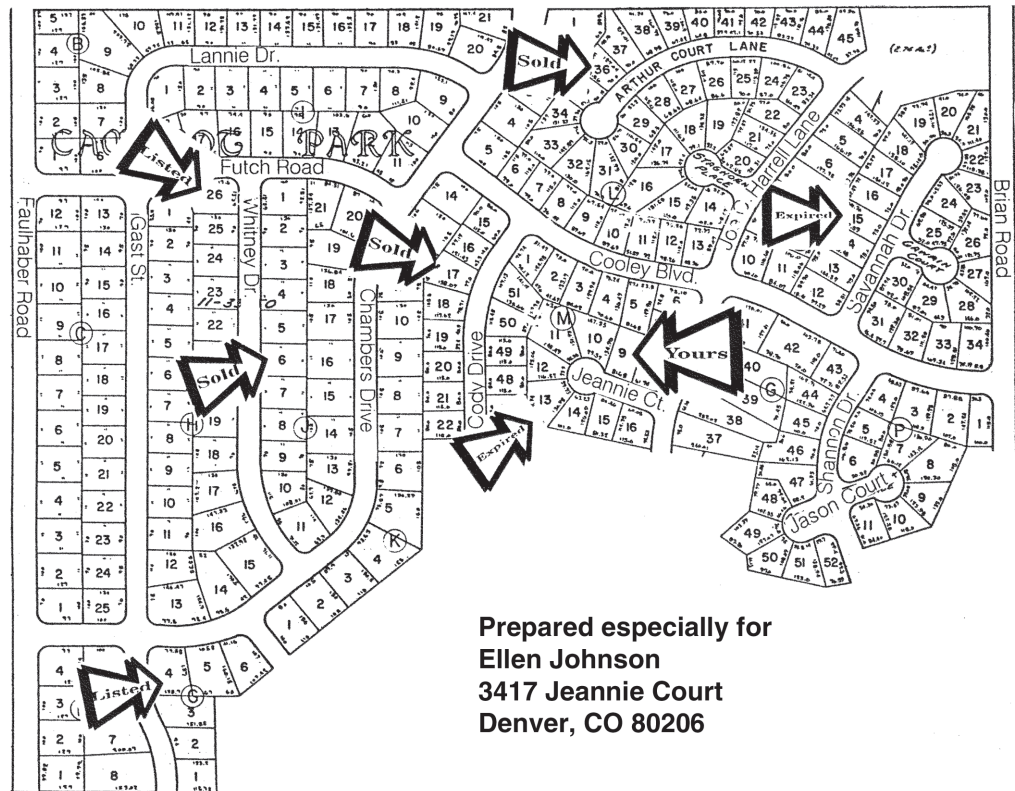
You have just completed a CMA for Tim Palmer's home at 1112 Bristol Court. The reconciled market value of his home is \$127,500. MLS statistics indicate that homes sell at approximately 95% of list price.

What is the range of value you would quote to Tim?

**A Visual Aid to the CMA**

"A picture is worth a thousand words" is a timeworn expression because it is true. Sellers who review CMAs with licensees often have difficulty visualizing the comparable properties. The licensee who provides visual data can make a clearer presentation, which may result in more realistic pricing. Owners who are motivated to sell do not set out to overprice their properties. Overpricing is usually the result of an inadequate understanding of the market, and that responsibility belongs to the listing broker-associate.

Valuable visual aids include plat maps of the subdivision and pictures of the comparable properties (see Figure 3.3). The plat map should be color-coded to show which properties were sold, which properties are now for sale, and which listings have expired. Photos can be shown from your local MLS data and printed from the MLS computer system, or taken with a digital camera. The licensee who wants the listing should not fail to also include a photo of the seller's home. The seller will appreciate your personal touch. Leaving a family home of some years can be a sentimental experience, and the seller will remember a licensee who is sensitive to those feelings.

**Figure 3.3: Plat Map of Neighborhood**

### **CMA's Using Comparable Sales and Listings (No Adjustments)**

Licensees commonly use this method to price property. It involves listing properties for sale now, properties sold in the previous year, and expired listings, without adjustments. Its simplicity is appealing to licensees and sellers alike because it provides an overview of the market. However, if properties on the chart are not comparable and the subject property is priced from an average of sales prices or square foot calculations, the pricing method can be misleading.

## Comparative Market Analysis

### Getting Information From the Owner

You have just received a request from John Seburg to discuss listing his family's home. He gives you the following basic information:

- The full name of all persons on the deed John L. Seburg and Susan C. Seburg
- The property address 4316 Landtowne Drive, Lakewood
- The owner's home and office phone number 720-555-3557; 720-555-3917
- The number of bedrooms and baths in the home Four bedrooms, two baths
- A description of extras in the home 1,920 square feet of gross living area, two-car garage
- A convenient time for an appointment. This is the time to decide whether to do a pre-presentation inspection of the property (two appointments required: one to inspect the property, one to present the CMA). You decide to have one appointment at 6:20 this evening and inspect the property at that time.

### Gathering Information From the Online Tax Rolls Through the MLS System

The tax rolls for Jefferson County show the following information for the property:

Legal description:	Lot 14, Block H, Landover Hills, Unit 2—Jefferson County
Property tax appraisal:	\$149,300
Annual taxes:	\$2,986.45
Year built:	1989
Base area:	1,920 square feet (later verified by physical measurement)
Total area:	2,420 square feet (includes two-car garage)
Last sale:	1996
Last sale price:	\$128,000
Mortgage:	Sun Title Bank

A search of the tax records shows seven sales in the subdivision within the previous year, ranging from \$168,000 to \$174,800. Six of the seven sales were reported in the MLS. The sales are shown in the first section of the CMA in Figure 3.4.

There are four properties currently for sale in the MLS, shown in the second section of the CMA, and three listings have expired within the last 12 months, shown in the third section.

### Analysis of Amounts Contributed by Amenities

Over a period of time, in reviewing data on sold properties, we can estimate what an updated kitchen, a garage, an extra bedroom, or a gas fireplace contributes to value. The matched pair technique would compare similar houses with and without a particular feature. The difference in price would tend to show what the feature contributes in value.

For purposes of this CMA, we will assume that sold properties in the neighborhood have shown the following value contributions over time:

- The contribution of an updated kitchen is \$4,000.
- The contribution of a gas fireplace is \$800.
- The contribution of an extra garage stall (two cars, rather than one) is \$2,800.
- The contribution of extra square footage differences is \$50 per square foot.
- The contribution of a large deck is \$2,000.

The CMA has been filled in with the exception of the adjustments shown earlier. Please compare the subject property with the comparable properties and make adjustments to the comparable properties. Then, complete the analysis and estimate the marketing range for the property.

Figure 3.4: Comparative Market Analysis

Prepared for: \_\_\_\_\_  
Property Address: \_\_\_\_\_  
Features: \_\_\_\_\_

Comparative Market Analysis

Prepared by: \_\_\_\_\_  
Date: \_\_\_\_\_

Properties sold within the previous 12 months

Property Address	Sales Price	List Price	Days on Market	Living Area	Features	Estimated Adjustment	Adjusted Sales Price	Comments
1816 Hibiscus	172,800	180,000	120	1,820	Updated kitchen, fireplace, large deck			
2412 Nasturtium	169,900	177,900	71	1,920	Fireplace			
1763 Camellia	173,500	182,000	45	1,900	Updated kitchen			
1421 Azalea	168,900	175,000	52	2,000	Large deck			
1640 Clover	171,200	179,500	61	2,000	One-car garage			
2210 Hibiscus	168,000	175,900	32	1,900				
1240 Camellia	174,800	182,500	70	1,920	Large deck, fireplace			
Percent sales price/list price				%				

Properties currently on the market

Property Address	List Price	Days on Market	Living Area	Features	Estimated Adjustment	As Adjusted	Comments
1818 Azalea	191,000	75	2,100	Updated kitchen			
1740 Hibiscus	178,800	120	1,900	Fireplace			
2210 Clover	185,000	38	1,820	Large deck, updated kitchen			
1604 Magnolia	177,000	45	1,920	Large deck			

Properties that were listed but failed to sell during the previous 12 months

Property Address	List Price	Days on Market	Living Area	Features	Estimated Adjustment	As Adjusted	Comments
221 Camellia	192,800	180	1,900	Updated kitchen, fireplace, large deck			
1812 Hibiscus	185,500	240	2,000	Large deck			
2211 Azalea	186,600	140	1,800	Fireplace			

This information is believed to be accurate, but is not warranted.  
This is an opinion of value and should not be considered an appraisal.

Median \$ \_\_\_\_\_

The suggested marketing range is \$ \_\_\_\_\_ to \$ \_\_\_\_\_



**FOR EXAMPLE**

In this role-playing session, assume the CMA has been explained but the seller is attempting to set an unreasonably high listing price. Find as many persuasive points as possible to encourage the seller to price the property in the range suggested.

**Computer-Generated CMAs**

As computers have become more important in every phase of the real estate business, software programs have been written that make impressive presentations to buyers and sellers. Many of these programs are formatted to print out an entire CMA and listing presentation to the seller, tailored to a customer's specific needs. In many cases, the time required is less than that of handwriting the old CMA grids. Most of the programs are designed to interface directly with the MLS system program and download the necessary data. This saves the licensee time because information does not have to be typed in. Most programs provide raw sales data without adjustments, although the broker-associate, by selecting only comparable properties, can come quite close to market value.

**SUMMARY**

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Normally, when listing or selling property, licensees prepare a comparative market analysis and give their opinion of value. Many important principles of value exist, including highest and best use, substitution, supply and demand, contribution, and conformity.

The comparable sales approach to estimating value is the most appropriate method; appraisers use this method to value homes and vacant sites. The comparative market analysis is the method most licensees use to prepare an opinion of value. The three sections of a CMA are properties that have sold recently, properties for sale now, and properties that did not sell during the listing periods (expired listings). Data for the CMA is gathered primarily from the MLS and county property appraiser's records. Only comparable properties should be used in the analysis. A range of values is provided to the seller because it is more meaningful than a single value.



# UNIT 4

## Making the Listing Presentation

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › List at least four requirements for a proper listing presentation.
- › List the five major steps in a listing presentation.
- › Describe the steps in explaining a CMA.
- › List two visual aids for a CMA presentation.
- › List the three major sections in a Seller's Net Proceeds Form.
- › List at least eight costs that a seller may be expected to pay at closing.
- › Explain why insurance and escrow amounts usually are not included in the Seller's Net Proceeds Form.
- › Explain the reasons for rounding all figures used in the Seller's Net Proceeds Form.
- › Prepare a Seller's Net Proceeds Form.
- › Describe the problems a FSBO may face when selling a house.

### KEY TERMS

equity

listing presentation

net proceeds

Seller's Net Proceeds  
Form

### OVERVIEW

When a licensee delivers an effective listing presentation, the close rate for listing appointments will be much higher. Prospecting is a numbers game. It may take up to 50 calls to get one listing appointment. What a shame it would be to have all that effort rendered worthless by failing to prepare carefully before sitting down with the sellers.

## REQUIREMENTS FOR THE PRESENTATION

The **listing presentation** is a “sit down at the dining room table” discussion at which all property owners and decision makers are present. It will be successful only if you

- know all the clients who need to sign your listing are available;
- are fully prepared to list the property, which means you must have all the forms ready for signature when the parties agree to list;
- know the presentation thoroughly (have practiced the presentation with someone before you use it with a seller);
- know about the house you are trying to list—use the information from the tax appraiser’s office, the plat books, or from your own personal inspection;
- have prepared a comparative market analysis that will help you show the sellers a fair value for their house and protect you from the overpriced listing, which will cost you time, aggravation, and unhappy customers;
- have your information organized in a businesslike fashion and your mind organized as well;
- are properly dressed and professional in appearance and manner; and
- are on time for the appointment.

## THE FIVE MAJOR SEGMENTS OF THE PRESENTATION

A listing presentation consists of the following five major segments:

- Building rapport with the sellers
- Explaining the pricing process (going over the CMA)
- Showing the sellers how much they might receive from the sale (the Seller’s Net Proceeds Form)
- Discussing the importance of listing the property with you
- Asking for the listing

### Building Rapport With the Sellers

1. Greet the sellers at the door with a smile and be yourself. Thank them for the opportunity to visit their home and, after some initial small talk, begin taking control of the interview.
2. If you haven’t already made a preliminary visit to the property, ask the sellers to give you a tour. Have a notepad to record your observations for each room. Ask questions about the house while on the tour. If you see any features that indicate the sellers’ hobbies, awards, or family photos, try to acknowledge them. Show the owners that you’ve done your homework by confirming some of the information you’ve gotten from the tax appraiser.
3. Inspect the property boundaries, make notes of exterior features, and then ask the sellers to help you measure the rooms in the house.
4. Arrange to have all parties sit at a dining or kitchen table. Suggest that the TV be turned down (or off) so that you can hear them well.
5. Find out why they are selling. If they are moving to a new town, find out how they feel (not think) about the move. Is it scary? Have the sellers met their new bosses? How do they feel about their new jobs? Let them know you care about them as individuals.

## Explaining the Pricing Process

The presentation should provide the information the sellers need to fully understand the listing process. Agents who give a value without first going over the CMA may lose the opportunity for realistic pricing if the sellers are surprised and offended at the value. A proper presentation should proceed in the following sequence:

1. Help the sellers understand current market conditions. You can get this information from MLS statistics or from your broker. Give statistics for the overall market. The CMA will help show the neighborhood statistics. For example, tell the sellers
  - a. the number of houses currently listed;
  - b. the number of homes sold last month; or
  - c. the month's supply of homes on the market (divide listed homes by sales).
2. Give the sellers your analysis of the market:
  - a. Is it a buyers' or a sellers' market?
  - b. Are prices rising or falling?
  - c. What is likely to happen if interest rates rise (or fall)?
3. Explain the importance of pricing the property within the selling range.
4. Inform the sellers that the purpose of the CMA is to determine the best list price for the property.
5. Explain the report and how you researched the material in it. If your conclusions of market value are less than the sellers' desired price, you may have a problem. Do not state your conclusions currently. Wait to see what the sellers conclude from the comparable sales. (Often sellers will quickly realize that their price is too high and, if motivated to sell, will agree to reduce the price.)
6. Explain how each section of the CMA is important in the decision-making process by giving the sellers an overview of the following:
  - a. Sold listings prove what selling prices have been and what bank appraisals might show.
  - b. Homes now for sale illustrate the importance of competitive pricing.
  - c. Expired listings demonstrate the futility of pricing property at an unrealistically high price.
7. Review individual properties on the report while referring to visual aids such as a subdivision map and photos.
8. Ask the sellers for questions or comments.
9. Give the sellers time to arrive at a range of values independently.
10. If the sellers want to price the property too high, discuss the reasons why that approach is unproductive.
11. When a realistic listing price has been agreed upon, complete the Seller's Net Proceeds Form.

## Presentation of a CMA

### Assumptions

Use the CMA on page 396.

Alice, the sales associate, visited the house yesterday when Susan Seburg was home to measure it, evaluate its features, and take some digital photos for the presentation this evening. This allowed her to prepare a CMA with confidence that there would be no surprises.

Cast:

Sales Associate: Alice Newton

Sellers: John Seburg, Susan Seburg

Alice: Mr. and Mrs. Seburg, thanks for inviting me into your home. Helping you get the most dollars for your home in a reasonable time is one of my most important responsibilities in my real estate practice. One of the ways I can really be helpful is by carefully preparing a market report. It's called a comparative market analysis. Have you seen one of these before? *(Hands them a copy of the CMA.)*

John: No, we haven't. But this is our first home.

Alice: Okay. It will take us a few minutes to go over it, but it's well worth the time. The decisions we make based on this analysis are going to be very important to you as we go forward.

You can see I've put your names and the address here at the top.

You can see that the report is broken into three main sections *(pointing)*: Here are the sales in your neighborhood for the last 12 months. The sold properties section tells us which homes appraisers can use and gives us an idea of the value for a homebuyer's bank appraisal. The section on properties that are now listed shows your competitors. And here are the properties that failed to sell, usually because they were overpriced. All of these properties are going to help us decide at what price we should offer your home. Here's a map of the neighborhood so you can see where each of these homes is located. Do you have any questions so far?

Susan: Well, I don't see one of our neighbor's homes on your list, and I know he sold his house last May. The address is 4425 Landtowne Drive.

Alice: Right. Let me see. *(Looks at another list of every sale in the area.)* Yes, you're right. Here it is on this list *(shows list)*. As you can see, his house had only 1,500 square feet, while yours has more than 1,900. I didn't use it in our pricing guide because it's just not comparable, don't you agree?

Susan: Yes, I see.

Alice: On each of the homes included on our list, I've made some adjustments based on major differences from your house. For example, the house at 1640 Clover has only a one-car garage, and yours has a two-car garage. The price difference for that feature is about \$2,800, so your house should sell for about \$2,800 more.

John: Okay, that makes sense.

Alice: You can see that in the first section, sold properties, the median sales price of properties—and what yours will probably appraise for—is about \$167,500. In the second section, your competition has a median listed price of \$177,500. Now, our best chance at a sale within a reasonable time frame is to price your home somewhere above the sold properties and below the competing properties. Does that make sense?

John: Sure does.

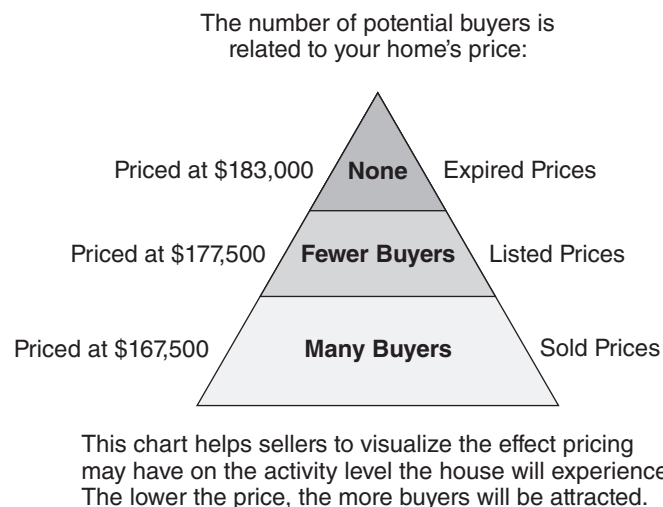
Alice: Here are the properties that were overpriced and stayed on the market a long time. They didn't sell. You can see they had a median price of \$183,000. We want to avoid being in this group, don't you agree? Let me show you the Pricing Pyramid. *(Shows them the pyramid [see Figure 4.1].)* As you can see, if you price the home at the median of the sold homes in your area, you'll attract the most buyers. If you price at what the other homes are listed for, you'll get some activity, but not as much. And if you price it too high, you won't see many buyers at all. The more buyers we can get to look, the better the chance of a sale.

John: Yes, we'd like to sell within the next few months.

Alice: Great. Based on what you've seen here, what price do you think would be the best price for us to put it on the market?

- Susan: Well, I think we've got to be somewhere between the sold ones and the listed ones. Do you think we could list it at the higher end, like \$177,500?
- Alice: What do you think, John?
- John: I'd like to get as much as possible, Susan, but two of the homes for sale now are at \$175,000. I think maybe \$174,500 might get it sold faster.
- Susan: Yes, that's true. I'm comfortable with \$174,500.
- Alice: I wholeheartedly agree. Could we schedule your home for our office inspection on Monday, or will the following week give you more time to get ready? (This is the first time the sales associate should ask for the order.)
- Susan: Well, we may not be quite ready to do anything yet. Can we think about it and let you know?
- Alice: Absolutely. Perhaps I could review with you what you are likely to clear from the sale after paying off the mortgage and all your expenses. Would that be helpful?
- John: Sure would.

**Figure 4.1: The Pricing Pyramid**



#### FOR EXAMPLE

Using the CMA report in Figure 3.4, role play the complete presentation of a CMA without referring to the previous script. With another person, present the different sections of the material. Assign one person to represent a reasonably motivated seller who is kind to the agent.

## Estimating the Seller's Proceeds

A seller generally is reluctant to enter into a listing agreement until he understands what expenses must be paid at closing. The **net proceeds** after paying off the mortgage and expenses of a sale are of primary interest to the seller and are often a factor in setting a list price. It is extremely important that a licensee use skill, care, and diligence in estimating the seller's proceeds from the sale. Following is a discussion of the **Seller's Net Proceeds Form** (see Figure 4.2).

On the Seller's Net Proceeds Form, a section for the seller's name and the property address should be completed. The left side of the form itemizes income and expenses related to the sale. Two columns are provided for calculations:

- *When listing the property.* The licensee uses column 1 when calculating an estimate based on a recommended price; the licensee uses column 2 if the seller wants to know how much a different list price would net.

- *When giving the seller a range of values.* The broker-associate could provide for the seller a high-end list price and a low-end list price.
- *At the time of listing.* Column 1 is used for showing the net proceeds if customary seller's expenses are to be paid; column 2 is used if the seller is asked to pay the buyer's loan closing costs. This is much like a best-case/worst-case scenario.
- *For estimates given at the time of listing.* Column 1 is for listing proceeds; column 2 is used when an offer is submitted.
- *At the time an offer is submitted.* Column 1 shows the seller's net if the offer is accepted; column 2 shows the seller's net if a counteroffer is accepted.

**Figure 4.2: Seller's Net Proceeds Form**

Seller's Name: _____		
Property Address: _____		
<b>Selling Price</b>	\$ _____	\$ _____
<b>Less:</b>		
1st mortgage		
2nd mortgage		
Other		
<b>Seller's Equity</b>	\$ _____	\$ _____
<b>Less: Expenses</b>		
Title insurance		
Homeowner's warranty		
Buyer's closing costs		
Buyer's origination fee		
Buyer's discount points		
Repairs and replacements		
Seller's attorney fee		
Brokerage fee		
Other miscellaneous costs		
Other		
<b>Total Expenses</b>	\$ _____	\$ _____
<b>Less: Prorations</b>		
Property taxes		
Interest		
Homeowners dues		
Rents and deposits		
<b>Total Prorations</b>	\$ _____	\$ _____
<b>Net Proceeds to Seller</b>	\$ _____	\$ _____
<p>These figures are estimates and intended only as a guide. Costs will vary at closing because of prorations, the mortgage balance, and unforeseen costs. An exact itemization will be provided to you at closing. Please read this and all other documents relating to this sale carefully. If you require further explanation, please consult an attorney.</p> <p>Date: _____ Prepared by: _____</p> <p>Seller: _____ Seller: _____</p>		



### ***Seller's Equity Section***

The seller's **equity** section consists of the sales price less mortgage balances and other encumbrances. Special assessment liens and construction liens are shown in the space provided for other encumbrances. All items should be rounded because this is an estimate. An exact mortgage balance is unnecessary because of the closing date's uncertainty. Uneven dollars and cents amounts should not be included. Exact amounts imply an accuracy that does not exist in the estimate.

### ***Expenses Section***

Any expenses that the seller might be required to pay should be listed. It is better to overestimate than to underestimate the expenses. A seller will not be unhappy to receive more at the time of closing than expected, but likely will be upset if expenses have been underestimated. Even though the bottom of the form provides a disclaimer, the licensee must be careful to avoid errors. Some expenses that should be discussed include the following:

- When making the seller's statement, the licensee should include the typical charge a seller might be expected to pay for title insurance and related costs based on local practice.
- Homeowners' warranty costs are often associated with the seller's need to assure the buyer that the home is in good condition and will be warranted against many defects by an independent home warranty company. Depending on the company, these costs may range from \$300 to \$500. The benefit is that most warranty companies will cover the seller for any problems that might occur during the listing period if the seller agrees to pay for the buyer's policy.
- Buyer's closing costs, the origination fee, and discount points can be very substantial expenses to the seller if the seller agrees to pay them. When taking a listing, a broker-associate should include these items as the custom in the market area dictates. When preparing this estimate at the time of contract, the broker-associate should take extra care if the seller is paying the buyer's costs. The licensee should use the lender's good-faith estimate, with a maximum amount agreed to in the contract. Leaving this open-ended in a contract can be a problem if the discount points or other costs increase between the time of acceptance and the time of closing.
- Repairs and replacements are usually those that a lender might require. They also could be the result of inspection issues or nonfunctioning appliances. The licensee should use a cushion for such contingencies.
- The seller's attorney fee is an expense left to the seller to determine with an attorney.
- The brokerage fee is the commission the brokerage firm charges.
- Other miscellaneous costs include items such as express mail fees for mortgage payoffs and recording mortgage satisfactions. The licensee should include a cushion here to allow for contingencies. A seller on a tight budget cannot afford unpleasant surprises. This line also could be used to round uneven expense amounts to even amounts. For example, if the expenses were \$8,945.60, the miscellaneous costs could be estimated at \$54.40, resulting in total estimated expenses of \$9,000.

### ***Prorations Section***

This section, if not carefully estimated, could result in an unpleasant surprise for the seller because most prorations are debits (charges) to the seller. Because the closing date is not certain, it is not necessary to do exact prorations; approximations are satisfactory if amounts are rounded higher. The statement offers no provision for insurance prorations or proceeds from a lender's escrow account. Insurance should not be prorated; the buyer should purchase a separate policy, and the seller should get a cancellation refund. Because the insurance refund and escrow refund from loans paid off are not received at closing, the net proceeds statement does not include these items. (If the mortgage is to be assumed, the prorations could be offset by the amounts held in escrow, as the buyer will be expected to reimburse the seller for those amounts.) The following are typical items that will be prorated between the seller and buyer at closing:

- Property taxes should be estimated for the year if tax information is not available. An assumed closing date is used to estimate prorations. If the closing were anticipated for June 28, for example, the licensee would show a charge to the seller for half the year's taxes.
- Interest prorations can be difficult to calculate. The amount depends on the time of month of the closing. Most interest is paid in arrears, but not all loans have that feature. The safest practice (if the loan is current) is to show a charge for a full month's interest.
- Homeowners dues can be substantial in some areas, particularly with condominiums and other properties that have substantial common maintenance areas. The dues may be paid in advance, but often are paid in arrears. The homeowner should be questioned about the status of the dues.
- Rents and deposits can be major charges to the seller of an income property. If the seller has collected rent in advance, the buyer is entitled to the rent for the part of the month after the closing. The buyer also should be paid the security deposits.

### ***Net Proceeds to Seller***

The net proceeds equal the seller's equity less expenses and prorations. The amount of the seller's proceeds should be rounded to the next lowest \$100.

**FOR EXAMPLE****Estimating Net Proceeds to Seller**

Estimating the seller's net proceeds properly is extremely important. This exercise should be completed carefully using the Seller's Net Proceeds Form in Figure 4.2. Round up on expenses, prorations, and mortgages, and do not use cents. The final estimate should be rounded to the lowest hundred, using the following information:

Seller's name	Cindy Lewis
Property address	1947 Oldfield Circle
Prepared by	Janice Brown
Estimated closing date	August 26
Sales price	\$93,800
Existing first mortgage (8.5%)	\$47,425
Home equity loan (11%)	\$14,659
Brokerage fee	7%
Buyer's title insurance	\$650
Repairs and replacements	\$450
Seller's attorney fee	\$350
Homeowner's warranty	\$375
Discount points	\$2,100
Annual taxes	\$1,325
Interest	?
Annual homeowners dues	\$150

**FOR EXAMPLE**

Using the Seller's Net Proceeds Form prepared in the previous exercise, role play the presentation of the form to the seller. With another person, present the different sections of the material. The seller should be reasonably motivated and kind to the agent. The licensee should ask a closing question when showing the net proceeds from the sale.

**Ask for the Order**

Show the sellers the net amount to be received and ask, "Can you live with this figure?" If the answer is "yes," follow up with, "Do you have any objections to my making the property available to all the REALTORS® in the city through the multiple listing service?" If the answer is that this would be okay, ask for the current mortgage information and proceed to fill out the listing forms. You have obtained the listing!

If the answer is "We are not ready to list at this time," say "I understand," then go to the next step.

## DISCUSS THE REASONS MOST FSBOS DON'T SELL

### The Problem of Showing the Property

1. Explain that the sign in front of the home invites any passersby to come to the front door and ask to be let inside. Normally, a resident of a home would never allow the person access, but it's now more difficult to say "no." Talk for a moment about the family security and explain that you'll escort all buyers after they are qualified.
2. Remind the owners that a buyer cannot know everything about her property by simply looking at the front of the house. This is a very important point, especially if the home has only average curb appeal but the inside is far nicer than average. Without knowing about the good features, a buyer might drive right by. You should explain that when you show the home, you will escort the potential buyers inside, where they can truly evaluate the home.
3. Remind the sellers that if they are not home all day, in the evening, and on weekends to show the home, the buyer may not call back. Every time they go shopping or go to work, their property is "off the market." Explain that when they list with you, the property will be on the market 24 hours a day, because buyers can reach a licensee who has the information the buyer wants.

### The Problem of Financing

Because the buyers will likely need financing on the property, you could explain that they may want assistance in deciding where to go for a home mortgage and may not understand the process. For this reason, many buyers ask for the help of a real estate professional.

### The Problem of Verbal Negotiations

Discuss with the sellers the disadvantage of direct negotiations with a buyer. Many buyers buy direct because their negotiation skills give them an advantage. Buyers will ask questions about the reason for selling and about how much lower the sellers might go. If the sellers remain firm, explain that the buyers may leave. But the sellers should also know that if they give a buyer a lower figure, that buyer may later try to negotiate even lower.

The sellers should be told that when a buyer wants to make an offer, the licensee will put it in writing and ask for a good-faith deposit so that if the price offered by the buyer is acceptable, all the sellers need to do is sign the contract.

### The Problem of Writing a Purchase Contract

You can ask sellers whether they have a contract form and whether they feel comfortable filling it in for the buyers to sign. If the sellers have a contract form and think they can fill it in, let them know about the education process most licensees undergo so they can write one that will not end up in court.

If the sellers say they have an attorney to write the contract, suggest that it's important for the attorney to be qualified in real estate practice. You might also raise the question of how quickly a good, but busy, attorney could get a contract written when a buyer is ready to buy.

## The Major Problem: Saving the Commission

In this last part of your discussion, you want to get the sellers' agreement that they are willing to try to overcome these obstacles to save the commission. When they agree, you must answer their objection to listing with you by letting them see that their efforts won't save a commission. Ask the sellers why they believe a buyer would be willing to take the time and make the effort to buy a house directly from a seller when the buyer could get much more help from a licensee. Then explain to them that the reason is that the buyer is also buying direct solely to save the commission and that it won't be possible for both parties to save the full commission. In the unlikely event that both the seller and buyer complete the transaction without help from a licensee, why couldn't both parties save the full commission?

## Ask for the Business

A closing question such as "Can you see why most people who try to sell their homes turn to a real estate professional?" might generate a positive answer. You can then ask if they'd like you to try to get the home into the MLS as soon as possible, or bring your office staff over on Monday morning to see it, or hold an open house next Sunday. If their response is positive, you can begin filling out listing paperwork.

In many cases, the sellers won't be ready to list with your company. You should ask for the reason, and if they want to think about it, you should tell them why, when they decide to list the property, the listing person should be you.

## Show the Seller Why the REALTOR® Should Be You

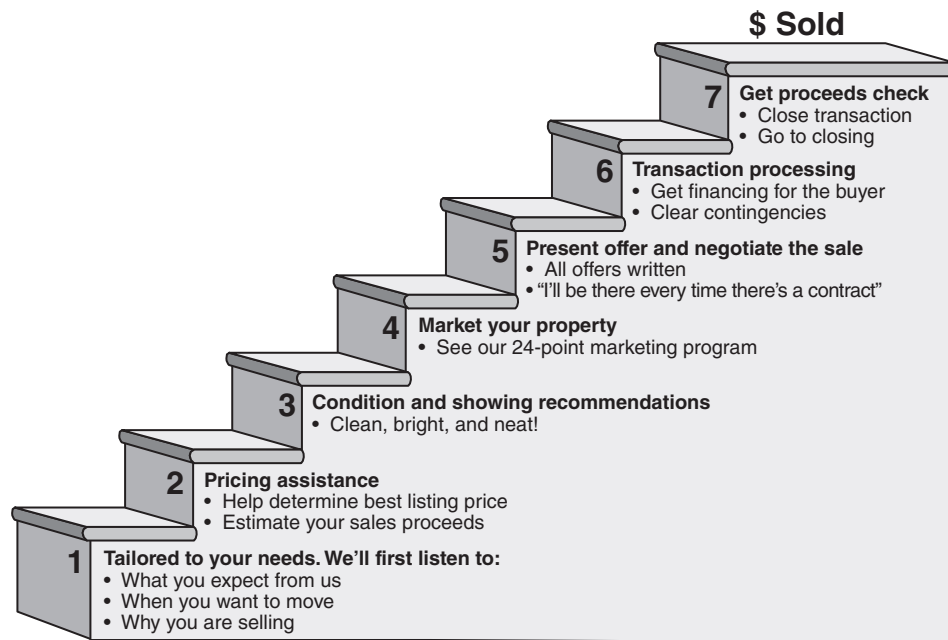
Tell the sellers that your brokerage firm and you

- are in a high traffic location,
- have a training program that makes all your associates more professional and successful,
- sponsor listing caravans to generate more sales,
- will put the home into the MLS,
- will extensively advertise the home,
- will hold open houses,
- are members of an out-of-town referral agency,
- offer a warranty program (then describe how that will help to sell the property),
- will call them each week to tell them of your progress, and
- will give them your special "Seven-Step Service" program.

## SEVEN-STEP SERVICE

A seller wants to know what the brokerage firm will do to earn the commission. A chart like the one shown in Figure 4.3 may be helpful to explain the brokerage firm's services. While the chart itself is rather sparse for easy understanding, the broker-associate should explain each step to the seller in more detail. After you have finished your presentation, you should clearly and directly ask for the order: "Mr. and Mrs. Seburg, may I help you sell your property?"

If the answer is no, you should review the presentation point-by-point, then ask for the order again. In many cases, the presentation will result in a listing. If for any reason you do not get a listing, arrange to visit again in three days. You may never get the listing, but it won't be because you gave up too soon.

**Figure 4.3: Seven-Step Service**

## SUMMARY

Making an effective listing presentation will result in a much higher close rate for listing appointments. Several conditions must be met to succeed:

- All parties on the deed must be present.
- All forms must be ready for the seller's signature. Get the ink signature at the presentation, then send them the electronic version if needed for their signature later.
- The licensee must know each step of the presentation.
- The licensee must have complete information about the property to be listed.
- A comparative market analysis must be prepared.
- The licensee must be organized, have a professional appearance, and be on time.

The five major parts of a listing presentation are the following:

- Building rapport with the sellers
- Explaining the pricing process
- Explaining the Seller's Net Proceeds Form
- Discussing the importance of listing with your brokerage firm
- Asking for the listing

A seller usually is more interested in the net proceeds from the sale of the property than the home's actual sales price. The Seller's Net Proceeds Form—the financial disclosure to the seller—consists of three major sections. The seller's equity section provides the sales price less mortgage balances, with the difference being the seller's equity. The expenses section shows expenses the seller must pay at closing. The prorations section includes taxes, interest, rents, and homeowners dues.

# UNIT 5

## Brokerage Relationships and Listing Contracts in Colorado

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Explain to a seller or buyer how brokerage relationships work in Colorado.
- › Explain the wording that could be used to protect both the seller and the broker from commission disputes caused by a buyer who improperly tries to leave the broker out of the transaction in an open listing.
- › State the legally required elements in a listing contract.
- › Explain the distinguishing characteristics of each of the following types of listings: open, exclusive brokerage, and exclusive right-to-sell.
- › Complete a listing contract.
- › Explain each paragraph of the listing agreement.
- › Design a listing servicing program for your personal listings.

### KEY TERMS

exclusive brokerage listing  
exclusive right-to-sell listing

lockbox  
open listing

profile sheet  
servicing the listing

### OVERVIEW

Before a Colorado broker-associate enters a relationship with a member of the public, the associate should have a full understanding of the duties and responsibilities she owes as an agent or transaction broker. Broker-associates in Colorado are allowed to work with members of the public in different roles: both representative and nonrepresentative. The broker-associate must be able to describe what each relationship means and help the member of the public decide how he wishes to work with the licensee.

A listing contract is an agreement between a real estate broker and a property owner. The listing contract specifies the duties of both the broker and the owner in the sale of the owner's real property. Without listing contracts, there would be little or no inventory to sell, exchange, lease, rent, or auction. In Colorado, there are three approved listing contracts that can be used by broker-associates when listing property for sale. Every written listing agreement must include a definite expiration date, a description of the property, the price and terms, the fee or commission, and the principal's signature. A legible, signed, true, and correct copy of the listing agreement must be given to the principal(s) once the listing agreement is signed. Also, a written listing contract may not contain a self-renewing or automatic renewal provision. It is important to understand that a listing agreement is a personal services (employment) contract that requires the brokerage firm to perform one or more professional services to fulfill the agreement. The listing broker-associate may seek assistance from other licensees, but the primary responsibility remains with the listing broker-associate and the brokerage firm that designated her to represent the seller. The listing contract is a broker's employment contract, and all listings should be in writing. If litigation should result from some misunderstanding, default, or breach, it is much easier to resolve by showing the terms of a written contract than by obtaining testimony to prove the terms or conditions of an oral listing.

## BROKERAGE RELATIONSHIPS AND CONFLICTS OF INTEREST

There are two levels of representation that a broker may offer a potential seller or buyer in Colorado: agency representation or transaction brokerage representation. The broker is said to be acting either as an agent or as a transaction broker. An agency relationship must be in writing (the exclusive right-to-sell contract and the exclusive right-to-buy contract both can be used to accomplish this agency relationship). If there is no written agreement and a broker is working with a potential buyer, Colorado law dictates that the broker is representing the buyer as a transaction broker (the default relationship in Colorado in the absence of a written agreement). In both cases, the law prescribes certain dos and don'ts that the broker must observe with respect to the client (the seller or the buyer). An agent must adhere to a very strict list of duties and prohibitions. A transaction broker must adhere to a more limited list of duties and prohibitions. In general, an agent can be thought of as an advocate and a consultant for the represented party, doing everything possible within the law to obtain the greatest advantage for the client. A transaction broker, on the other hand, is more properly thought of as a facilitator or mediator, responsible for helping the seller or buyer complete the sale (or purchase) but stopping short of offering opinions and strategic advice.

Broker-associates may also work with a member of the public in a nonrepresentation role in which they have no relationship or duty; the member of the public will be an unrepresented customer. The broker-associate owes the customer reasonable skill and care and accounting for any money received. Additionally, the licensee can help the unrepresented customer write an offer to present to the seller. This type of relationship, however, must also be expressed in writing. The broker and member of the public who wish to work together without any level of representation must sign the required Brokerage Disclosure to Buyer or Brokerage Disclosure to Seller (FSBO) form. If there is no written agreement between a broker-associate and the buyer she's working with, the broker-associate is by default representing the buyer as a transaction broker.

In certain situations, a broker-associate or a brokerage firm may be in a position to represent both the buyer and the seller of a particular property. Often called *double-ending* the transaction, this situation presents a difficult legal issue regarding confidentiality and disclosure. A broker-associate representing both the seller and the buyer would be privy to confidential information about both parties, which could give rise to a conflict of interest. Typically, the seller's agent has a legal duty to tell the seller anything advantageous learned



about a potential buyer and to keep certain information about the seller confidential, while the buyer's agent has the same duties with respect to the buyer. For example, the seller's agent (the listing broker) would know the absolute lowest price the seller is willing to sell the property for, even though the list price is higher. The law forbids the licensee from disclosing this information to a potential buyer (unless instructed to do so by the seller). On the other hand, the law requires the buyer's agent (the buyer's broker) to inform the buyer of material information learned, such as the fact that the seller would be willing to sell for a lower price than the list price. When the same broker represents both the seller and the buyer, how does the broker comply with these conflicting duties? Another situation that historically has given rise to a potential conflict of interest is one in which one broker-associate in a firm lists a property for sale and another broker-associate in the same firm finds a buyer for that listing. In some states, when one broker-associate represents a buyer or seller, the entire brokerage firm is considered to be the seller's or buyer's agent. This gives rise to the same sort of potential conflict of interest described earlier. Some states get around this issue by permitting dual agency. The broker double-ending the transaction or the firm with one broker representing the seller and another broker representing the buyer are deemed dual agents, and the confidentiality and disclosure requirements are modified slightly to permit the agents to protect each client's interests without violating the law.

Colorado does not permit dual agency and has instead legislated a solution called designated brokerage. The brokerage firm is no longer seen as the agent or transaction broker representing the seller or buyer. Instead, the firm simply owns the contract and designates one of their broker-associates to represent the parties. Firms must have a written office policy that specifies which types of relationships their brokers can offer the public. Most firms allow their broker-associates to negotiate the relationship with the party that is signing the agreement (seller or buyer) and offer agency or transaction brokerage as they feel is appropriate to that transaction. This avoids a potential dual agency situation since only the individual designated broker-associate is deemed to have the relationship with the party, and he agrees not to share confidential information about the party with any other brokers in the firm or outside of the firm. Should another broker in the same firm find a buyer for the property, this concept of designated brokerage would permit the second broker to represent the buyer with no conflict of interest.

In a situation in which the broker-associate can double-end a deal, the broker must make a choice. Since Colorado designated brokerage law does not allow the broker to be agent to both parties, the broker can do one of two things: (1) move to the middle and act as a transaction broker (facilitator) for both parties or (2) continue to be an agent for one party and treat the other party as an unrepresented customer. This situation most frequently arises when a broker lists a property for sale and establishes an agency relationship with the seller, then finds an interested buyer while marketing the property. The broker must have the seller's permission to change from agency representation to transaction brokerage representation. This allows the broker-associate to offer transaction brokerage representation to the buyer as well, thereby representing both parties with no conflict of interest. This potential change of representation is one of the crucial concepts the listing broker-associate must explain to the seller when they negotiate the listing agreement. The seller chooses the type of representation to hire the broker-associate for (as an agent or as a transaction broker). If the seller chooses an agency relationship, indication must be made in the listing agreement whether to permit the broker-associate to change to a transaction broker should that broker-associate be the one to find a potential buyer. Some sellers may not wish their broker-associate to offer any representation to potential buyers. More often, however, the broker-associate will explain the options to the seller when completing the listing agreement and the seller will choose to allow the broker-associate to switch to a transaction broker should the situation present itself.

The same issue must be discussed when a buyer wishes to hire a broker-associate to help her find a home. The exclusive right-to-buy contract requires the broker-associate to explain the difference between agency representation and transaction brokerage. The buyer must indicate his choice in the appropriate section of the agreement. Again, some buyers will decide to allow the broker-associate to change to a transaction broker if that broker-associate finds an unrepresented seller for a property the buyer wishes to purchase. Other buyers will require their broker-associate to remain their agent and prohibit the broker-associate from offering representation to any and all sellers they may find.

## REPRESENTATION DUTIES

When a broker-associate signs a listing agreement or buyer representation contract with a buyer or seller to act as an agent or a transaction broker, they are agreeing to perform a group of uniform duties.

As stated in the Colorado Real Estate Manual, the uniform duties of an agent or a transaction broker when representing the seller or buyer are as follows:

- The broker must exercise reasonable skill and care for the seller or buyer, including, but not limited to
  - performing the terms of any written or oral agreement with the seller or buyer,
  - presenting all offers to and from the seller or buyer in a timely manner regardless of whether the property is subject to a contract for sale,
  - disclosing to the seller or buyer adverse material facts actually known by the broker,
  - advising the seller or buyer regarding the transaction and to obtain expert advice as to material matters about which the broker knows but the specifics of which are beyond the expertise of the broker,
  - accounting in a timely manner for all money and property received, and
  - keeping the seller or buyer fully informed regarding the transaction.
- The broker must not disclose any of the following information without the informed consent of the seller or buyer:
  - That the seller is willing to accept less or the buyer is willing to pay more than the asking price for the property
  - What the motivating factors are for the seller or buyer to sell or buy the property
  - That the seller or buyer will agree to financing terms other than those offered
  - Any material information about the seller or buyer, unless disclosure is required by law or failure to disclose such information would constitute fraud or dishonest dealing
  - Any facts or suspicions regarding circumstances that could psychologically impact or stigmatize the property
- The seller or buyer consents to the broker's disclosure of the seller's or buyer's confidential information to the supervising broker or designee for the purpose of proper supervision, provided the supervising broker or designee does not further disclose such information without the consent of the seller or use such information to the detriment of the seller.

- The brokerage firm may have agreements with other sellers to market and sell their property or with buyers to buy property. The broker may show alternative properties not owned by the seller to other prospective buyers and list competing properties for sale. The broker may show properties in which the buyer is interested to other buyers without breaching their agreement.
- The broker is not obligated to seek additional offers or to find additional properties to purchase the property while the property is subject to a contract for sale.
- The broker has no duty to conduct an independent inspection of the property for the benefit of a buyer and has no duty to independently verify the accuracy or completeness of statements made by the seller or by independent inspectors. The broker has no duty to conduct an independent investigation of a buyer's financial condition or to verify the accuracy or completeness of any statement made by a buyer.
- The seller or buyer is not liable for the acts of the broker unless such acts are approved, directed, or ratified by the seller.

## ADDITIONAL DUTIES OF THE SELLER'S OR BUYER'S AGENT

If the Seller or Buyer Agency box at the top of page 1 of the representation contract is checked, the broker is a limited agent of the seller (seller's agent) or buyer (buyer's agent) with the following additional duties:

- Promoting the interests of the seller or buyer with the utmost good faith, loyalty, and fidelity
- Seeking a price and terms that are acceptable to the seller or buyer
- Counseling the seller or buyer as to any material benefits or risks of a transaction that are actually known by the broker

## Disclosure of Brokerage Relationships

Commission rules require a broker-associate who is either an agent or a transaction broker working with a seller to disclose that brokerage relationship to a potential buyer *in writing* before providing brokerage services to the buyer. The same is true if the broker-associate is representing a buyer and approaches an unrepresented seller (FSBO). The broker-associate is allowed to have rapport-building conversations and may discuss general terms and market conditions. It is imperative, however, that before eliciting or receiving any confidential information the broker-associate discloses his brokerage relationship to the unrepresented member of the public.

The disclosure might start on the phone:

“Ms. Jones, I appreciate your calling on my listing. You seem to be very excited about the home, and I would like to work with you. I need to tell you that at this time I represent the seller as an agent. This means that I would be required to take any confidential information that you give me to the seller. Colorado allows real estate brokers to work with buyers and sellers in a variety of ways. It is possible for me to work with both you and the seller and maintain your and the seller's confidential information. Could you meet me at my office to discuss how we can work together, and then we can make arrangements for me to show you that home?”

Disclosure must be in writing at first physical contact. To continue from the previous example:

“Thank you for coming in, Ms. Jones. As we discussed on the phone, Colorado real estate brokers can work with buyers and sellers in a variety of ways. I would like to review the relationships we can offer using this form (Brokerage Disclosure to Buyer). When we’ve reviewed the form, we can discuss how we can work together and set a time to see the homes you are interested in.”

The broker-associate would then walk Ms. Jones through all the options that are available, using the form, to help her decide how she would like to work with the broker-associate. The broker-associate should ask Ms. Jones to sign the disclosure form, give her a copy, and put the other copy in the file. If Ms. Jones will not sign the form, the broker-associate should note that the disclosure was given, state the time and date and that signature was refused, and put the copy in his file.

## TYPES OF LISTING CONTRACTS

In this unit, three types of listing contracts are identified. We will briefly deal with open listings and exclusive brokerage listings; however, the exclusive right-to-sell contract is emphasized because of its predominance in residential property transactions.

### Open Listing

An **open listing** is a contract in which an owner reserves the right to employ any number of brokers. Brokers may work simultaneously, but the first broker who produces a ready, willing, and able buyer at the terms accepted by the seller is the only one who earns a commission. If the owner sells the property without the aid of any of the brokers, the owner is not obligated to pay any commission; however, if a broker can provide proof of being the procuring cause of the transaction, that broker may be entitled to a commission.

### Exclusive Brokerage Listing

While in law and practice this type of listing is called an exclusive agency listing, in Colorado, because the listing does not represent the brokerage relationship but a type of brokerage service, it is called an exclusive brokerage. The seller and broker-associate decide if the brokerage relationship is an agency or transaction broker relationship by checking one of the boxes on page 1 of the listing.

The **exclusive brokerage listing** is the preferred listing agreement of an owner who has selected one broker as an exclusive agent or transaction broker, for a specified period, to sell real property according to the owner’s stated terms. In an exclusive brokerage listing, the owner appoints the broker but reserves the right to sell the property without paying a commission to the broker if the broker has not introduced or identified the buyer. If the broker performs by selling the property before the owner, the broker is entitled to a commission. Exclusive brokerage residential listings are less common than exclusive right-to-sell listings.

A common problem with exclusive brokerage and open listings is the exposure to lawsuits for procuring cause between the broker and the seller.

**FOR EXAMPLE**

Carlos Garcia lists Donald Wilson's home under an exclusive brokerage listing agreement. Carlos shows the property to Marcie Farkas. Marcie notices that the seller has a sign on the property saying For Sale By Owner—555-1145. Carlos drops Marcie off and writes a letter to Donald, registering Marcie as a prospect. Immediately after Carlos drops her off, Marcie calls Donald directly. Donald does not know that Carlos has shown the property and agrees to a reduced price since no commission is involved. Donald and Marcie enter into a contract for sale. It is only after the contract is signed that Donald gets Carlos's prospect registration letter. When the sale closes, Carlos sues for commission as the procuring cause of the sale.

Role play the court argument: Carlos, arguing for a commission on the sale, and Donald, explaining why no commission is due.

In the example, Donald, whom we assume to be an honest person, was sued because of the buyer's actions, not his own. How can a broker prevent this type of misunderstanding? Registration is not enough, because the notification may come after the parties have entered into a contract. A better method to help the seller receive fair disclosure is for the broker-associate to recommend that the seller require the following words in all contracts the seller believes to be the procuring cause of the sale:

This property is listed with a broker under an agreement that the broker will be paid a commission for procuring a buyer for the property. Buyer warrants to seller that the buyer was not shown or made aware of this property by any real estate broker or broker-associate. Buyer agrees that if a broker claiming a commission provides information to the contrary, buyer will reimburse seller for commissions due to said real estate broker as well as legal fees.

A buyer who has seen the property with a broker will refuse to sign such a statement, putting the seller on notice that the buyer is trying to save the commission by excluding the broker.

Two other problems can arise from an exclusive brokerage agreement. First, a broker is reluctant to show property to a buyer if the owner's phone number is displayed prominently on a sign in front of the property. The sign invites the buyer to exclude the broker to get a better price. If the broker takes the listing under an exclusive agency, the broker should get the owner's agreement to remove the sign.

Another problem the broker faces is the possibility of the owner's advertising a lower price (broker's price less commission). The broker likely will lose the buyer if the buyer sees the owner's ad. The broker and the owner should quote the same price.

**Exclusive Right-to-Sell Listing**

The **exclusive right-to-sell listing** is the most advantageous listing from the broker's viewpoint and the most common type of listing. The listing is given to a selected broker, who then becomes the exclusive broker for the sale of the property. The broker is due a commission regardless of who sells the property. That is, if the owner sells the property during the contract period, the broker still earns a commission. Also, if the owner sells the property within a designated time period after the listing contract has expired to a buyer originally introduced to the property by the broker, the owner usually is liable for a sales commission to the broker (the holdover or extension clause).

To be enforceable, this type of listing contract should be in writing and include valuable consideration. Only exclusive right-to-sell and exclusive brokerage listings may be entered into the MLS by the listing broker.

## Warranties by the Owner

Both the broker and the seller have obligations under the listing agreement. The seller has legal obligations to the broker, including performance of all promises made in the contract, as well as the obligation to engage in honest, straightforward dealing. The actions and misrepresentations of a seller can become a liability to the agent. For example, if a seller tells a broker-associate that the plumbing pipes are copper and the broker-associate passes along that information to a buyer without qualification, both the seller and the brokerage firm may be liable for damages if the buyer later discovers the plumbing pipes are polybutylene. Litigation may result in damages assessed against both the seller and the broker.

The licensee is expected to be knowledgeable about and have a full understanding of all the contracts she uses. A broker-associate should be able to fully explain each section of the contract clearly and completely. Sellers lose confidence if the broker-associate is unable to explain or doesn't understand a section. In this section, we are going to discuss what is typically filled in the blanks and how to explain the document to the seller.

- Before filling out the listing agreement, the broker-associate and the seller should have had a discussion in regard to what type of brokerage relationship the seller and broker-associate are going to have. The Definitions of Working Relationships form is a helpful tool in this discussion. The broker-associate can offer the seller any relationship that is allowed under her employing broker's office policy, usually either agency or transaction broker. Then, through discussion between the seller and broker-associate, the final decision on representation takes place.
- It is helpful for the seller to have available the documents they received when buying the home. This will enable you to have the deed to verify the legal description, information on the lender, and so on.

## Explaining the Agreement to the Seller

The presentation of the listing agreement to the seller needs to be thorough to ensure that the seller fully understands the agreement. Broker-associates sometimes take a casual approach to explaining the listing agreement or offer no explanation at all to the seller. A broker-associate may say, “Don’t worry, it’s the standard agreement. Sign here.” Or the broker-associate might try to give an explanation, even though he doesn’t understand the agreement, either. This misleads the seller and is not an acceptable practice. The licensee’s job is to give the seller an understanding of the important provisions the agreement contains.

New broker-associates should understand the agreement totally and explain each paragraph clearly. If a seller asks, “What happens during the listing period if I decide I want to lease the property to a tenant?” the broker-associate should give a complete answer based on the details of the agreement: “If you’ll look at paragraph 18(d), you’ll see that the property can be leased. You agree to pay my company a fee of 3.5%, but the fee does not include management.”

The professional broker-associate explains the listing agreement in language that the seller understands easily. Role-playing is an excellent method of learning this skill. When the role-playing results in wording that sounds appropriate, the broker-associate should write it down and then refer to the written explanation during the listing appointment.

The following scenario might result from a licensee’s role-playing exercise:

“Mr. Jones, this is the standard agreement all Colorado brokers must use to list homes. Let’s go over it together, paragraph by paragraph.

“This top section shows the standard headings. This is a binding contract, and if you don’t understand it or anything we discuss you should contact an attorney, tax professional, or other counsel before you sign. It also states that compensation to our firm is negotiable.

“As we discussed earlier, there are a number of relationships that are available with our firm. As you may recall, you and I decided that I would represent you as your agent, which is why I have checked that box.

“Section 1 says this is an exclusive and irrevocable contract for the time period we will agree on in a few minutes.

“Section 2 shows that I belong to a multiple-person firm and that I will be designated by my company to represent you in the sale of your property.

“Section 3 shows your name as the seller, K&C Realty as the brokerage firm, and me as the broker. Do I have your name spelled correctly? Also, if you can give me a copy of your deed I will check to make sure that the legal description I copied from public records matches the deed.”

The broker-associate continues to explain sections 3 through 34 of the listing contract in a similar manner. She refers to the checklist in Figure 5.2 to be certain she has completed all the necessary documents and taken all the necessary actions in regard to the listing.



**Figure 5.2: Listing Procedure Checklist**

**Listing Procedure Checklist**  
**(Your company may have its own form.)**

Complete Brokerage Relationship Disclosures in accordance with the Colorado Real Estate Manual (CREM).

You do not need signed disclosures if you have a signed listing agreement.

This form should accompany all listings.

Property address: \_\_\_\_\_

Listing associate: \_\_\_\_\_

**Listing Packet Contents** (bold print indicates seller's signature is required):

- ☐ Comparative market analysis
- ☐ Brokerage relationship disclosures
- ☐ **EXCLUSIVE RIGHT-TO-SELL CONTRACT**
- ☐ MLS profile sheet
- ☐ MORTGAGE STATUS REQUEST
- ☐ **SELLER'S PROPERTY DISCLOSURE**
- ☐ **HOME WARRANTY AGREEMENT**, if seller agrees to provide one
- ☐ SELLER'S NET PROCEEDS FORM
- ☐ Survey, if available
- ☐ Copy of mortgage and note
- ☐ Copy of deed restrictions
- ☐ Title insurance policy
- ☐ Key to property
- ☐ Floor plan, if available
- ☐ Copy of seller or buyer referral sent out
- ☐ Three ads
- ☐ Sign installation form
- ☐ Lockbox installation form
- ☐ Client contact sheet
- ☐ Copy of MLS computer printout

**Office Action:**

- ☐ Get office manager's approval on listing forms.
- ☐ Enter listing data into computer.
- ☐ Put copy of printout into Floor Duty Book.
- ☐ Distribute copies of printout to all sales associates and broker-associates.
- ☐ Turn in listing packet to secretary.

**Follow-Up Action:**

- ☐ Return all original documents to seller.
- ☐ Send seller copy of the MLS listing book photo and information.
- ☐ Contact seller weekly.
- ☐ Send seller copy of mortgage status letter when received.
- ☐ Send copies of all ads to seller.
- ☐ Follow up on all showings.



**FOR EXAMPLE**

Using the listing agreement, paraphrase the legal words in everyday language that will help a seller understand the agreement better. In a group situation, each person should be assigned a paragraph. The person then explains the paragraph to the group in lay language and the group provides constructive criticism. Because each person would explain each paragraph differently, every broker-associate should prepare his own written text for use in presentations.

## Closing for the Listing

All necessary forms should be completed by this time. The best approach is to have the seller sign the hard copy or digital listing contract and all forms at the same time rather than sign each form as it is presented. A sample conversation is shown in Figure 5.3.

### Figure 5.3: Getting Signatures on Listing Documents

Ms. Reyes and Ms. Jackson, we agreed to market the property at \$275,000. Based on that figure, we reviewed the statement showing your expenses of the sale and what you would receive as proceeds. Here's a copy for your records, and I need you to okay this form for our records. (After they sign the form, put it back in your stack.)

Okay. You completed the disclosure statement that we'll give to buyers when they are interested in the home. This will protect you from later claims that you held back important information. I need your signatures here, please. (After they sign the form, put it back in your stack.)

Great. We've gone over the agreement for us to market your home. I need your okay right here. (After they sign the form, put it back in your stack.)

I appreciate your confidence, and I'll start the marketing of your home right away. I'm going to get back to the office and prepare information to put the property into the MLS. Before I leave, do you have any questions?

## Marketing the Listing

The seller employs the listing broker to market the property. Many sellers believe that the listing broker has not done her job unless she actually sells the listing. The licensee should discuss this misconception with the seller during the listing presentation. The seller should understand that if the licensee does the job properly, the house will sell through the licensee's marketing efforts—both to potential buyers and to other licensees, who will show the property to their buyers.

The broker has been hired to get the best price in the shortest time and with the least inconvenience to the seller. This requires the licensee to market the property in ways other than just showing it. Some of these activities include the following:

- Disseminating the property information to all agents in the company
- Putting the sign on the property
- Putting an MLS lockbox on the property (if approved by the seller)
- Arranging for all company broker-associates to inspect the listing on caravan day
- Getting the information into the MLS as soon as possible (it is unethical and self-serving to withhold the information from other brokers and broker-associates while the agent attempts to sell the property)

- Announcing the listing at company sales meetings and at board of REALTORS® marketing meetings
- Preparing a brochure to place in the home for prospective buyers and cooperating licensees
- Scheduling an open house, if appropriate for the listing
- Writing at least three good ads to generate potential buyers
- Putting the listing on websites (personal page, company page, and other advertisers' pages)
- Using email auto responders to send immediate feedback to customers who request information through the websites
- Preparing mail-outs to send to potential buyers
- Preparing a property brochure and a Let's Make a Deal package for potential buyers and other broker-associates to be left on the property
- Telling 20 neighbors about the listing by mail
- Calling the neighbors to ask for help in finding buyers (check the do-not-call list first)
- Holding a REALTORS® luncheon at the property to increase activity
- Reviewing sales and listing activity in the neighborhood and updating the CMA at least once a month

A detailed marketing program such as this could be the basis for a Satisfaction Guarantee or Steps to a Successful Sale listing presentation.

The purpose of the Let's Make a Deal package is to give the buyer's broker-associate all the documents necessary to write an offer. Without these documents the offer would be contingent upon the buyer receiving and reviewing them to continue with the process (see Figure 5.4).



#### **FOR EXAMPLE**

Prepare a 30-point marketing plan for a brochure you could use in your listing presentation. Brainstorm to come up with different marketing ideas.

**Figure 5.4: Let's Make a Deal Package**

Items to include:

A front page with the following information:

- Property address, including the ZIP code and the legal description
- The listing brokerage firm and broker-associate's address and contact information
- The amount of earnest money and whom the check is made payable to, if other than the listing firm
- The possession date for the property
- A request to contact the listing broker before writing the offer

Copies with signatures of the following:

- Seller's property disclosure or source of water addendum
- Square footage
- Lead-based paint disclosure
- Closing instructions
- Earnest money receipt
- Any other items that might be needed, such as surveys, easements, or any items that the buyer should have knowledge of before writing an offer

The purpose of the Let's Make a Deal package is to give the buyer's broker-associate all the documents necessary to write an offer. Without these documents the offer would be contingent upon the buyer receiving and reviewing them to continue with the process.

**Servicing the Listing**

**Servicing the listing** is often more important than acquiring it. "I never hear from my broker!" is probably the complaint sellers make most often about their broker-associates. A seller who does not hear from her listing broker-associate may perceive that the broker-associate is not doing his job.

**FOR EXAMPLE**

You are a real estate broker-associate who is quite busy and disorganized. You have had a listing for six months that is about to expire and you wish to renew it. Despite your best intentions, you have failed to contact your clients, Harold and Deidra, for more than two months. As time progressed, it became harder for you to make the call. You set an appointment to visit the home at 7:30 pm. Because you are caught in traffic, you are 20 minutes late when you walk up to the house. You are surprised to see that a competitor has listed the property next door. Even worse, it has a contract pending sign attached. Harold answers the door, nods his head seriously, and says, "Well, stranger. Long time, no see!"

Role play this situation. Try your best to re-establish the trust and rapport you had at the beginning of the listing period. It may be instructive enough that you will never allow this situation to happen in your career.

Professional licensees who are successful do not succeed on the strength of their sales skills alone. These licensees are successful because they provide service to their clients and customers. Often, a family's home is the largest asset they will ever have, so a broker-associate must never take the marketing of the home lightly. Failure to maintain regular contact with a seller is a detriment to a broker-associate's future success.

Several methods ensure that a broker-associate will contact each seller at least once a week:

- The broker-associate selects one evening each week, such as Thursday night, to service listings.
- The broker-associate contacts every seller in person, by phone or, if personal contact is not successful, by mail or email.
- The broker-associate clips every ad from every paper and homes magazine, then pastes it on a note card and mails it with a note that says, “Thought you’d like to see a recent ad on your home. Regards, Sally.”
- The broker-associate calls the seller after every showing by a cooperating broker and gives feedback about the visit to the home. At a minimum, the broker-associate should call once a week with feedback on all showings. If there have been no showings, this is another opportunity to discuss the market with the seller.

Often broker-associates lose touch with sellers because they don’t know what to talk about and feel that they sound like broken records because they say the same things over and over. But it’s better to maintain consistent communication even if there is nothing new to report. Sellers have a lot at stake and feel better knowing their broker has not forgotten about them.

Each broker-associate should prepare a Listing Servicing Schedule, which provides a basic format for the servicing of every listing. A sample form is shown in Figure 5.5.

**Figure 5.5: Listing Servicing Schedule**

Property Address: \_\_\_\_\_ H Phone: \_\_\_\_\_ W Phone: \_\_\_\_\_  
 Sellers’ Names: \_\_\_\_\_ Children: \_\_\_\_\_

**First Day:**

- ☐ Verify tax information and legal description.
- ☐ Send out mortgage status request.
- ☐ Write three ads.
- ☐ Place listing on web page.
- ☐ Send thank-you card to seller.
- ☐ Enter listing information in computer.
- ☐ Put copies of listing information in floor book.
- ☐ Distribute copies of listing information to all sales associates.
- ☐ Put sign and lockbox on property.

**Second Day:**

- ☐ Mail out notice of listing cards to at least 20 neighbors.
- ☐ Call or email seller to tell of earlier steps.

**End of First Week:**

- ☐ Send letter to seller signed by employing broker.

**Day after Caravan:**

- ☐ Collect caravan comment sheets.
- ☐ Visit with seller to evaluate results of caravan and comments.

**Second Week:**

- ☐ Clip ads of property. Send to seller in postcard format.
- ☐ Check MLS information on computer, verify information, and then email to seller.
- ☐ Call seller to tell of progress. Ask seller to call when house is shown.

**Figure 5.5: Listing Servicing Schedule (continued)****Third Week:**

- ☐ Clip ads of property. Send to seller in postcard format.
- ☐ Run MLS computer check for new listings and listings under contract, then email information to seller.
- ☐ Call or email seller to find out who has seen home.
- ☐ Check with sales associates who have shown home; give feedback to seller.

**Fourth Week:**

- ☐ Clip ads of property. Send to seller in postcard format.
- ☐ Run MLS computer check for new listings and listings under contract, then email information to seller.
- ☐ Call or email seller to find out about who has seen home.
- ☐ Check with sales associates who have shown home; give feedback to seller.

**Fifth Week:**

- ☐ Clip ads of property. Send to seller in postcard format.
- ☐ Run MLS computer check for new listings and listings under contract, then email information to seller.
- ☐ Visit seller in the home and go over CMA. Get price reduction if appropriate.
- ☐ Walk through property again. Point out areas needing attention.

**Sixth Week:**

- ☐ Clip ads of property. Send to seller in postcard format.
- ☐ Run MLS computer check for new listings and listings under contract, then email information to seller.
- ☐ Call or email seller to find out who has seen home.
- ☐ Check with sales associates who have shown home; give feedback to seller.
- ☐ Schedule open house for the property, if appropriate.
- ☐ Send notice of open house to at least 20 neighbors.

**Seventh Week:**

- ☐ Run open house, and leave a note for seller on results. Call later.
- ☐ Clip ads of property. Send to seller in postcard format.
- ☐ Run MLS computer check for new listings and listings under contract, then email information to seller.
- ☐ Call or email seller to find out who has seen home.
- ☐ Check with sales associates who have shown home; give feedback to seller.
- ☐ Send out notice of listing to additional 20 homes in neighborhood.

**Eighth Week:**

- ☐ Clip ads of property. Send to seller in postcard format.
- ☐ Run MLS computer check for new listings and listings under contract, then email information to seller.
- ☐ Call or email seller to find out who has seen home.
- ☐ Check with sales associates who have shown home; give feedback to seller.

**Ninth Week:**

- ☐ Clip ads of property. Send to seller in postcard format.
- ☐ Run MLS computer check for new listings and listings under contract; then email information to seller.
- ☐ Call or email seller to find out who has seen home.
- ☐ Check with sales associates who have shown home; give feedback to seller.
- ☐ Do another CMA. Visit with seller and get price reduction and extension.
- ☐ Schedule luncheon for sales agents.

**Tenth Week:**

- ☐ Clip ads of property. Send to seller in postcard format.
- ☐ Run MLS computer check for new listings and listings under contract, then email information to seller.
- ☐ Call or email seller to find out who has seen home.
- ☐ Check with sales associates who have shown home; give feedback to seller.

Continue this pattern until the listing has been sold.

## WHEN LISTINGS DON'T SELL

Occasionally, broker-associates feel that they are wasting their time listing property. “I make more money working with buyers. I have 10 listings and haven’t earned a dime!”

Broker-associates who feel that way may need to evaluate their listing inventory using the Listing Quality Report in Figure 5.6. It is important to remember that one listing generates three sales: (1) the property itself, (2) the seller’s new home, and (3) at least one buyer for another property that the listing broker meets while marketing the home. While buyers looking for a property often generate only the one sale, properly priced listings are the key to becoming a top-producing broker.

**Figure 5.6: Listing Quality Report**

		310 Main St.		412 First St.		821 Jones St.	
		Yes	No	Yes	No	Yes	No
Listed at recommended CMA price?			✓		✓		✓
House in good condition?		✓			✓		✓
Seller motivated?		✓		✓			✓
Yard sign?		✓		✓		✓	
Easy showing access? (Lockbox, etc.)		✓		✓		✓	
Good curb appeal?			✓	✓			✓
Recommended price reduction		\$10,000		\$15,000		\$17,500	

A.	B.	C.	D.	E.	F.
Address	Time Left	List Price	Chance of Sale During Term	Quality Volume (C × D)	Recommended Price Change
310 Main St.	3 months	\$205,000	25%	\$51,250	\$10,000
412 Monroe St.	1 month	\$178,200	10%	\$17,820	\$15,000
821 Jones St.	2 months	\$312,500	40%	\$125,000	\$17,500
1250 Sipa Rd.	4 months	\$285,000	60%	\$171,000	\$10,000
116 Third St.	5 months	\$180,000	30%	\$54,000	\$10,000
<b>TOTAL</b>	<b>Avg: 3 months</b>	<b>\$1,160,700</b>	<b>1.65 listings</b>	<b>\$419,070</b>	<b>\$62,500</b>

Notice that the bottom part of the listing evaluation indicates that the broker-associate who may have five listings has the equivalent of only 1.65 listings (adding the percentages of chance of sale). The associate may boast of a listing volume of \$1,160,700 (average of \$232,140) but really has the equivalent of only \$419,070 (average of \$83,814) when considering the chance of sale.

Overpriced listings result in frustration for the broker-associate and resentment by the owner, who may become more demanding and tell friends of the lack of effort on the part of the broker-associate. Sometimes, if the seller will not price the property appropriately, it may be best for the broker-associate to give the listing back to the seller. An appropriate comment would be “We value our relationship with you and don’t want you to feel we are not being productive. I feel you may be unhappy with us later on if we didn’t give you the opportunity to talk with other agencies.”

If the broker-associate internalizes this evaluation and mentally reviews it when taking a listing, it is more likely that only salable listings would be taken thereafter.

## SUMMARY

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Three major types of listing agreements are open listings, exclusive brokerage listings, and exclusive right-to-sell listings. Licensees should carefully review and thoroughly understand the listing contracts they use. A licensee should be able to clearly explain to a seller the important provisions of a listing agreement.

A licensee must market property with skill, care, and diligence. A major part of the licensee's professional duties, in addition to listing and selling, is servicing listings and keeping in touch with sellers on a regular basis.

## APPLY WHAT YOU'VE LEARNED

The following actions reinforce the material in Units 2 through 5:

- Set up your power prospecting database. Start with your close friends and family, then list all the friends and past customers you can think of. After that, try to think of anyone even vaguely familiar that you have met and get the names down. You can get the addresses and contact information later.
- If you own a home, estimate its current value, then prepare a CMA. If you do not own your home, do this exercise for a friend. Does the CMA support the value you estimated?
- Based on the CMA you did on your or your friend's house, prepare a Seller's Net Proceeds Statement.
- Complete a listing agreement for your home, along with other forms required by your broker. Ask your broker to review them.
- Prepare an MLS computer input form describing the features of your house. Be certain it is complete.
- Write three practice ads to market your home.
- Pick a neighborhood in your city with homes priced from \$200,000 to \$250,000. Find as many sales as possible for the previous 12 months. Using the matched pair technique, identify the dollar contribution from
  - a deck or mountain view,
  - an extra bedroom,
  - an enclosed garage, and
  - a corner lot.
- Using the same analysis, calculate the percentage difference between listing price and selling price.
- Using MLS data, divide the number of houses on the market by the number of house sales last week to find how many weeks' supply of homes are on the market. Do this at least once a month. It's an excellent indicator of market activity.
- Write a script for the explanation of a CMA to a prospective seller. Record your presentation on audiotape to hear how it sounds. Edit as necessary until it sounds just right.
- Record your explanation of the approved exclusive right-to-sell contract. Edit your remarks until you are satisfied.





# UNIT 6

## Working With Buyers

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Explain four different ways to enhance your product knowledge.
- › List at least five sources of buyers.
- › Give at least three methods to show a buyer why an appointment with you will be beneficial.
- › List two important reasons for qualifying a buyer.
- › Explain how prioritizing buyers benefits both the buyers and the broker-associate.
- › Qualify a buyer using the Fannie Mae/Freddie Mac housing expense ratio and the total obligations ratio.
- › Calculate the total monthly payment (PITI) on a mortgage loan.
- › Qualify a buyer using the do-it-yourself prequalification form.
- › List two benefits in having a buyer prequalify at a mortgage lender's office.
- › List the steps between setting up an initial appointment with a buyer and writing a contract for purchase.
- › Explain why you would show a limited number of homes to a potential buyer in one day.

### KEY TERMS

canvassing  
fallback list

prequalification  
previewing properties

qualifying

### OVERVIEW

Working with buyers is an important function of the professional real estate broker-associate. Buyers are interested in working with knowledgeable, caring broker-associates and generally are reluctant to make appointments without evaluating the broker-associate's skills. A broker-associate must be adept at handling telephone inquiries, know the inventory, and stay current with available financing plans. Above all, the broker-associate must understand and observe the laws with respect to required disclosures and fair housing.

PRODUCT KNOWLEDGE

A buyer usually benefits from working with a licensee, regardless of the brokerage relationship, because of the licensee’s product knowledge. It is hard work to acquire the extensive product knowledge that buyers expect. To become proficient, the broker-associate should accomplish the following goals:


- Spend a majority of the first few weeks in real estate looking at property.
- See at least 30 new properties each week.
- Keep a record of listings viewed by using a client follow-up program or lead database or even by using index cards grouped by price range and outstanding features. The broker-associate may use the cards like flashcards to remember five good listings in each price range, or five with pools, or five fixer-uppers. With practice, the broker-associate can remember more listings than five.
- Constantly practice matching neighborhoods with price ranges or house sizes.
- Prepare a Five-Star Homes List showing the best-buys-on-the-market sheet for each price range (for instance, \$175,000 to \$200,000). A sample Five-Star Homes List is shown in Figure 6.1.

If a buyer calls to ask for an address for one of the broker-associate’s listings, the broker-associate should provide the information to the caller and, if needed, use “my five favorite homes on the market in your price range” to get an appointment with the buyer.

Figure 6.1: Five-Star Homes List



FIVE-STAR HOMES (BEST BUYS ON THE MARKET) Price Range: \$175,000–\$200,000			
Price	Address	MLS #	Comments
\$176,900	116 Belmont Rd.	15432	Great deck, vaulted ceiling
\$179,500	1272 Scenic Rd.	16523	Brick, large oak in front
\$185,000	784 Wilson Ave.	16132	Wood frame colonial
\$185,000	1216 Kara Dr.	15478	Huge back yard with hot tub
\$188,500	8754 Skate Dr.	15843	Heavily wooded, secluded
\$199,900	124 E. Call St.	16021	Downtown, arched doorways



**FOR EXAMPLE**

If you actively sell residential properties, try to name from memory the location for at least three one-story, four-bedroom listings. Try to name the location for four listed homes with mountain or city views.

FINDING BUYERS

Some good sources of buyers include

- calls resulting from advertising,
- past customers and clients,

- friends and family,
- open house visitors,
- canvassing prospects, and
- buyer seminar attendees.

## Calls Resulting From Advertising

Advertisement calls are less frequent now that home sale information is available online, but if calls are received, they may be a source of buyers. A buyer calls for more information to determine whether a house is right for him. A buyer seldom calls to make an appointment with a broker-associate, but the broker-associate's objective is *always* to get the appointment with the buyer. The broker-associate must remember two important points when answering buyer advertisement calls:

- It is difficult for the broker-associate to talk intelligently about properties that she has not seen. For this reason, the broker-associate should see every company listing before answering calls on ads or signs.
- The broker-associate should review all company advertising in newspapers and homes magazines. The licensee should clip each ad and paste it on a separate piece of notebook paper or index card. A **fallback list**, sometimes called a *switch list* or *pivot list*, should be prepared for each ad. A fallback list comprises three to five properties that are similar to the property being advertised. The list can consist of the broker-associate's personal listings, the brokerage firm's listings, or other brokers' listings. If a caller isn't satisfied after learning more about the property in question, the broker-associate can refer to the fallback list of other properties that might be suitable. The fallback list becomes invaluable in getting the appointment and helping the buyer find the right property. A sample fallback list is shown in Figure 6.2.



### FOR EXAMPLE

Do a role-playing exercise with another person, who will act as a buyer calling on an ad for 3415 Monitor Lane. Try to get an appointment using one of the methods discussed.

**Figure 6.2: Fallback List**

Address	MLS #	Price	Comments
1546 Merrimac Dr.	16546	\$89,500	Large workshop, lots of trees, 2 streets over
1247 Thresher Ln.	16478	\$94,500	20' × 30' deck, spotless
1687 Woodgate Way	16521	\$95,000	2 stories, 4 bedrooms, close to town
1856 Hoffman Dr.	16493	\$85,000	Huge oak in front, lots of azaleas, big kitchen
1260 Dunston Ct.	16470	\$92,500	Quiet street off Meridian, very clean, bright

Often, a caller wants a property's address but is unwilling to give a name or phone number. "I just want to ride by to see whether I like it," the caller says. The broker-associate will not get the appointment unless the caller will benefit by meeting with the broker-associate. The best-buys sheet and the fallback list may come in handy to get the appointment. Most buyers would then feel that the broker-associate had market information that would make it worthwhile to make an appointment.

Another way to suggest to the caller that meeting with the broker-associate would benefit the caller is to explain that many listings are not advertised. Many of the best properties are sold almost immediately by broker-associates who watch carefully for new listings for their clients or customers. Many buyers want to know that someone constantly watches the market for the right properties for them. “Would you like to have first opportunity to see these prime properties?” is the question that can get the appointment.

When a caller is adamant about wanting an address but will not make an appointment, some broker-associates do not give the address because they will lose the call. It is not worthwhile, however, to generate ill will with the consumer. Perhaps a better approach is to be helpful in every way. Ask how many property ads the caller has circled in the newspaper or homes magazine. Tell the caller you will provide an address and information on each listing advertisement, even though other real estate companies hold the listings. You should have a copy of the classified ad section and a homes magazine handy. Follow along with the caller, mark each ad, and set a time that you can get together. Prepare a list with addresses, prices, square footage, and other property features. The attraction to the buyer? One call gets it all because the consumer sees a benefit to meeting with the licensee. The attraction to the broker-associate? The buyer places no calls to the competition and an appointment has been set.

Once an appointment is made, it is time to evaluate the buyer’s needs and financial capabilities. This is called **qualifying** the buyer.

Often, the first visit with the buyer is simply a get-acquainted visit, meant for making required disclosures and for qualifying. After this is completed, a second appointment is set to show properties.

## Past Customers and Clients

One of the best sources of buyers is past customers and clients because they already have enjoyed the benefits of the broker-associate’s services. Agency representation may be a problem, however. If the broker-associate listed a client’s property in a prior relationship, the person may feel that the same agency relationship exists in the purchase of a new home. The broker-associate must give the buyer the appropriate brokerage relationship disclosures to re-create the relationship.

## Friends and Family

Among the broker-associate’s first sources of buyers when starting out in real estate are friends and family. The agent should write to everyone he knows and stay in contact for news of potential customers. When working with a friend or family member, the broker-associate must evaluate the loyalty issue to decide whether being a single agent for the buyer is more appropriate than being a transaction broker.

## Open House Visitors

Holding open houses is a good way to find prospective buyers. The primary objective of an open house is not to make the seller happy (a sale makes the seller happy) but to get buyer prospects. If the buyer purchases the home on display, so much the better. The broker-associate should prepare a brochure for the home with the broker-associate’s name and picture prominently placed.

Often open house visitors are just looking or are neighbors curious about the house. The broker-associate should tell visitors that they are welcome to walk through the home but that there are a few features that are not readily apparent. If this home is not right for the visitors, the licensee should have ready a list of the five best homes in the price range as well as a fallback list, then set an appointment to talk. If the visitor is a neighbor, ask them if they are thinking about selling. If yes, schedule an appointment.

## Canvassing Prospects

**Canvassing** is an excellent method of finding buyers. The same canvassing call can be a source of either buyers or sellers. The broker-associate might ask, “Do you know someone who may be getting ready to buy or sell real estate?” Often the answer is yes and the broker-associate can set an appointment. Remember, you may not call anyone on the National Do Not Call Registry.

## Buyer Seminar Attendees

Many broker-associates and brokers consider buyer seminars to be outstanding prospecting tools and offer them to the public to attract large numbers of buyers at one time. Some real estate companies have impressive materials and workbooks for attendees of the classes, which run over two or three evenings. Often, attendees pay a nominal fee to cover the cost of books. Most seminars entitle an attendee to schedule a one-hour consultation with the seminar leader about a specific real estate problem or need. This can benefit both the consumer and the licensee if a business relationship results. Remember that the appropriate brokerage relationship disclosures must be made.

# QUALIFYING THE BUYER

It is a waste of time to show properties the buyer does not like or cannot afford. So, before showing properties, the broker-associate must get the answers to two important questions: (1) What are the buyers’ housing objectives? (2) What can the buyers afford to pay?

## What Are the Buyers’ Housing Objectives?

Some of the information the broker-associate should get from the buyers includes the following:

- What features do they want in the home?
- How quickly do they need to move?
- Must the buyers sell their current home?
- If they’re leasing now, when does the lease expire?
- Have the buyers already spoken to a lender and been preapproved?
- Is there a specific area in which they want to live?

## Desired Features

The broker-associate should ask the buyers what features the home *must have* and what features would be *nice to have*. The *must have* could be features such as a particular area of town, four bedrooms, or a two-car garage. The *nice to have* might be features such as high ceilings, an updated kitchen, or a wood deck.

**Urgency Level**

The broker-associate also needs to know the buyer’s urgency level. Each buyer should be classified based on urgency and motivation to purchase (see Figure 6.3). A person needing to move within the next 30 days, for example, is a Priority 1 buyer, needing immediate attention. A person who doesn’t have an immediate need, but who should not be ignored, is classified as Priority 2. A buyer who either will not or cannot purchase immediately is Priority 3 and should be contacted regularly for showings. If a buyer relocating to the city is in town just for the weekend to purchase a home, the broker-associate knows this is a Priority 1 buyer. After financial qualifying shows the buyer to be capable of making a purchase, the broker-associate might say, “It sounds like your situation needs my full attention. If you approve, I’ll clear my calendar so we can find the right home for you.” A buyer whose present lease expires in six months has less urgency to purchase now and is classified as Priority 3.

**Figure 6.3: Prioritizing Your Buyers**

Buyer’s Situation	Priority Level
Needs to move within 30 days or in town for the weekend to find a house	1
Wants to buy a house within the next three to six months	2
Can’t buy right now but is just starting to look; perhaps on a lease expiring next year	3

**Current Housing Situation**

If the buyers currently own a home that must be sold, one of the first actions should be to look at their home and make a listing presentation. After their home is listed, the best way to motivate the buyers to price their present home competitively is to show homes they might want to purchase during that listing period. When they see the right home, they will be prepared to sell their own quickly.

If the buyers are currently leasing, the licensee must determine when the lease expires. That will help in prioritizing the buyer.

**Buyer’s Family Helping in the Decision**

The broker-associate must also find out whether someone other than the buyer will be involved in making the final purchasing decision. If the buyer’s uncle will evaluate the final choice, the broker-associate should try to get the uncle to see each property along with the buyer. Why? The uncle may have a better grasp of the market and of property values and may help the buyer reach a decision sooner.

**Best Times to See Property**

The licensee must find out what times are most convenient for the buyers to look at properties. Are they available during the day? Can they come immediately to see a property if the right one comes on the market? Or does their job situation require that they see properties only in the evenings after work or on weekends?

**Describing the Process to the Buyer**

At the first meeting with the buyer, the broker-associate should provide, in addition to the agency disclosure form, a clear picture of the entire process, from the time of this first meeting until the day the buyer moves into his new home. The buyer who understands the process

is less likely to become uneasy or reluctant to purchase when finding the right property. The goal of this meeting is to have the buyer sign a buyer representation agreement. This lets the broker-associate know the buyer is serious and makes sure the broker will get paid when the buyer buys. It is the first of many commitments the buyer will be asked to make in the process, and a very important one for the broker-associate. The buyer should be given a copy of the purchase agreement and the broker-associate should explain important provisions in the agreement. A buyer's cost disclosure should be prepared for the home the buyer desires. This also helps in the financial qualifying process. A buyers presentation is a good way to ensure the buyer understands the entire process so there are no avoidable problems in the process.

## **Working With Buyers on a New Home Purchase**

### ***Nonstandard Builder Contracts***

Builders or developers do not fall under the purview of the Colorado Real Estate Commission and therefore rarely use the Commission-approved Contract to Buy and Sell. Typically, the attorney for the builder drafts a sale contract that is then used in the new home development. This contract usually favors the builders. Broker-associates should be aware that the builder may or may not be willing to change any of this agreement, parts of which may not be in the buyer's best interest. Broker-associates should counsel their buyer in regard to the different aspects of builder contracts before the buyer finds his dream property. The buyer should always be advised to seek legal or other counsel.

### ***Earnest Money Not Held in Trust***

Earnest money may be held by the brokerage firm or any other third party if parties to the sales contract agree. Very often with new homes the builder will want to hold the earnest deposit. A discussion with the buyer before showing new home developments allows her the opportunity to determine if she is comfortable with the builder keeping the earnest money, especially if the builder will be able to use the money for construction costs.

### ***Warranties and Completion Dates***

Typically, the builder will offer a warranty with the purchase of a new home. Broker-associates should make sure the buyer clearly understands exactly what the warranty covers before entering into the contract. Additionally, it is important that the buyer understand what will happen if the builder does not meet the completion date. Discuss what the builder is willing to do for the buyer if the property is not completed on time. The broker-associate should make sure that all of the agreements are in writing and signed by both parties.

## **Accompanying and Registering a Buyer**

Most new homebuilders expect a licensee to be with a buyer at the first showing of the property. The broker-associate should determine what is required to register the buyer with the builder. Registration allows the broker-associate to be protected if the buyer returns without the broker to view the property. Many builders will not pay a broker-associate who has not registered the buyer at the first showing. Buyers should be carefully counseled relating to this requirement when the buyer has signed an exclusive right-to-buy contract with the broker-associate. If the buyer buys any property without the broker's involvement, the buyer may still be obligated to pay the brokerage commission.

### ***Soil Report and Required Disclosure and Warning***

Colorado Law states:

- (1) At least fourteen days prior to closing the sale of any new residence for human habitation, every developer or builder or their representatives shall provide the purchaser with a copy of a summary report of the analysis and the site recommendation. For sites in which significant potential for expansive soils is recognized, the builder or his representative shall supply each buyer with a copy of a publication detailing the problems associated with such soils, the building methods to address these problems during construction, and suggestions for care and maintenance to address such problems.
- (2) In addition to any other liability or penalty, any builder or developer failing to provide the report or publication required by subsection (1) of the section shall be subject to a civil penalty of five hundred dollars payable to the purchaser.
- (3) The requirements of this section shall not apply to any individual constructing a residential structure for his own residence. (Colorado Revised Statutes Title 6: Consumer and Commercial Affairs § 66.5101: Disclosure to purchase—penalty)

### ***Financial Qualification***

Financial qualification with a reputable lender is crucial to a successful sale. If the buyer contracts for a home and applies for a loan that is later denied, the seller, buyer, and broker-associate have wasted time and effort. Licensees should explain both issues to their clients to help them understand the importance of financial qualifying.

Financial qualification is designed to determine how much money the buyer can borrow for the purchase of property. The broker-associate has two ways to qualify a buyer financially:

- Have a financial institution prequalify (or, better, preapprove) the buyer.
- Use a do-it-yourself prequalification form.

### ***Lender Prequalifying vs. Preapproval***

Having a lender prequalify or preapprove the buyer is the best approach and should be used whenever possible, but certainly before the buyer contracts for property. **Prequalification** is a lender's evaluation based on answers to questions given by the prospective buyer. Preapproval is given only after the buyer has been interviewed and the buyer's credit report has been reviewed and income verified.

A lender's preapproval letter makes the buyer's offer much stronger in the eyes of a seller and will result in more contracts.

### ***Do-It-Yourself Prequalification Form***

While licensees rarely do the financial prequalification for a buyer, the prequalification form (see Figure 6.4) gives the licensee an opportunity to understand the process. It is better to have a lender prequalify the buyer because the lender will provide a letter to the seller that assures the seller that the buyer will qualify for their loan.



**Figure 6.4: Do-It-Yourself Prequalification Form (for Conventional Mortgage Loans)**

Purchase price	\$	115,000.00	(A)
Desired mortgage amount	\$	92,000.00	(B)
Term of mortgage		30 years	
Mortgage rate		7.0%	
Loan-to-value ratio: (B) ÷ (A) =		80.0%	(C)
GROSS MONTHLY INCOME	\$	3,000.00	(D)
Mortgage principal and interest payment: (Payment factor: 6.6530) × (B) ÷ 1,000 =	\$	612.08	
Annual real estate taxes ÷ 12 =	+	110.21	
Homeowner's insurance premium ÷ 12 =	+	50.00	
MONTHLY HOUSING EXPENSES	\$	772.29	(E)
Car payments	+	250.00	(D)
Alimony or child support payments	+	225.00	
Credit card or charge account payments	+	50.00	
Other loan payments	+		
FIXED MONTHLY OBLIGATIONS	\$	1,297.29	(F)
HOUSING RATIO (E) ÷ (D) = 25.7%			
DEBT RATIO (F) ÷ (D) = 43.2%			

Purchase price	(A)
Desired mortgage amount	(B)
Term of mortgage	
Mortgage rate	
Loan-to-value ratio: (B) ÷ (A) =	(C)
GROSS MONTHLY INCOME	(D)
Mortgage principal and interest payment: (Payment factor for a __%, __-year loan: __) × (B) ÷ 1,000	
Annual real estate taxes ÷ 12 =	
Homeowner's insurance premium ÷ 12 =	
Mortgage insurance: (B) × 0.00025 (if (C) is more than 0.80)	(E)
MONTHLY HOUSING EXPENSES	(D)
Car payments	
Alimony or child support payments	
Credit card or charge account payments	
Other loan payments	(F)
FIXED MONTHLY OBLIGATIONS	
HOUSING RATIO (E) ÷ (D) = %	
DEBT RATIO (F) ÷ (D) = %	

Source: Thomas C. Steinmetz, *The Mortgage Kit*, 4th ed. (New York: Kaplan Publishing, 1998), 33.

Most lenders adhere to Fannie Mae/Freddie Mac standards in reviewing loan applicants. Those agencies recommend the maximum housing expense ratio (front) of 28% and the maximum total obligations ratio (back) of 36% for qualifying potential buyers for first mortgage (conforming) loans. The Federal Housing Administration's (FHA) maximum housing expense ratio is 29% and the maximum total obligations ratio is 41%. These figures are guidelines only. Many portfolio lenders will vary from these guidelines so that a prospective buyer who does not meet the guidelines may still be able to talk with a lender that will make the loan.

The common reason buyers don't qualify under the Fannie Mae/Freddie Mac standards is usually the back ratio: total obligations. If that number is too high, perhaps a creative lender can still help by increasing the qualifying income or suggesting prepaying some installment debt to less than 10 months so that it's no longer counted. A very high credit score could also help get the loan. Other compensating factors include the following:

- Having a good record of promotions and raises
- Having little or no installment debt if the housing expense ratio is high
- Making a down payment greater than 20%
- Having saved money while making rent payments higher than the mortgage payments of the new mortgage
- Having a job with good benefits, such as a company car, a free health plan, and high company contributions to a 401(k) plan



#### FOR EXAMPLE

Mark Ellis and Will Cleare make \$41,400 in gross annual income. They wish to purchase a \$150,000 home, with \$30,000 as a down payment. Fixed-rate, 30-year mortgages are at 7%. The monthly principal and interest payment is \$798.36. Taxes for a home in this price range are approximately \$1,440 per year. Insurance is approximately \$540 per year. No private mortgage insurance is necessary because the loan-to-value ratio does not exceed 80%.

The couple has installment loan payments totaling \$70 a month and a car payment of \$320.

Using the Do-it-Yourself Prequalification Form, determine whether Mark and Will qualify for this loan.

**FOR EXAMPLE**

The following role-playing skit, designed to highlight mistakes some broker-associates make in their first meetings with prospective buyers, allows both spectators and participants to learn from the process. Three actors are needed—a broker-associate and two buyers. All persons in the skit should be as enthusiastic and realistic as possible. During the presentation, if the broker-associate says something that may violate the law or ethics, group members should shout “Zap!” to signify their disapproval. At the end of the exercise, group members should be able to itemize the broker-associate’s errors and recommend responses to the buyers’ questions.

**Buyers’ First Meeting With a Licensee**

The buyers, Travis and Ashley Camp, walk in and are greeted by the broker-associate.

**Licensee:** Hello, may I help you?

**Travis:** Yes, we are here to see Lee Wilson.

**Licensee:** I’m Lee. You must be Mr. and Mrs. Camp?

**Ashley:** Yes, we are. Very nice to meet you.

**Licensee:** Great. Please sit down. *(Pauses while they sit.)*

**Travis:** Our mutual friends, the Joneses, recommended we get in touch with you.

**Licensee:** Yeah, the Joneses send me lots of people. By the way, if you send me anyone who buys a house, I’ll give you \$50.

**Ashley:** That’s what they told us. I hope you can find us a good deal, too.

**Licensee:** I love working with buyers, Mrs. Camp, and because I’m a transaction broker, I can work harder on your behalf.

**Ashley:** Well, do you have any distress sales of houses in the \$100,000 range that we could take advantage of?

**Licensee:** As a matter of fact, my company just listed one. The listing broker-associate suggested that I look at it. Confidentially, the owners’ business is in trouble, and they need to sell quickly. I have heard they are desperate and probably would come off the price as much as \$6,000, but we should start even lower to get the best counteroffer.

**Travis:** Tell us about it.

**Licensee:** Well, it’s in Bent Tree Estates, close to Lake Jackson. It’s got three bedrooms, two baths, a large lot, and a two-car garage. It’s in absolutely perfect condition.

**Ashley:** The newspaper ran an article last week suggesting that buyers get a home inspection. Is that a good idea?

**Licensee:** It is if you want to spend \$300 for nothing. I’ve looked over the house, and it’s perfect. No problems whatsoever.

**Travis:** I need to tell you that we may have a problem qualifying for a new loan. I had some credit problems last year, and we got turned down on another house we tried to buy. We really need to get an assumable loan with no qualifying.

**Licensee:** Well, we're in luck again. If you like this house, you can buy it with less than \$8,000 down. We'll have to structure a wraparound loan to beat the due-on-sale clause, but I do that all the time. Can you work with \$8,000 down?

**Travis:** I think we can come up with that much, if we can get the right price. Can we put some kind of contingency in the contract in case I can't get the money?

**Licensee:** Hey! I can write up a contract with contingencies that will let you out at any time with no risk. Don't worry about that. But let's go see it.

**Travis:** Should we have an attorney?

**Licensee:** You know what's wrong with five attorneys up to their necks in sand?

**Travis:** *(Smiles.)* No, what?

**Licensee:** Not enough sand. *(Laughs.)* Seriously, folks, you don't need an attorney. I can help you with anything an attorney can.

**Ashley:** Can we ask you some more questions first?

**Licensee:** Sure. Go ahead.

**Ashley:** Is it a good neighborhood?

**Licensee:** Oh, yeah, there are hardly any minorities living there!

**Ashley:** Well, I didn't mean that. I meant is it pleasant and well maintained?

**Licensee:** Oh, sorry. Yes, it's really nice.

**Travis:** Do you need us to sign any disclosure forms now?

**Licensee:** No, not really. Not until we write a contract for a house.

**Travis:** Well, let's go looking. I hope it works out.

**Licensee:** I'll do everything I can for you. *(The Camps leave. He calls to an associate in the office.)* Hey, Jim! I'll be back in a while. I've got some flakes with no money again, but I'm going to show a house!

Is it possible to learn from mistakes? The mistakes made in this skit may seem ridiculous, but these statements are actually made—although probably not all in a single transaction. Broker-associates must be alert during their presentations and when answering questions to avoid these mistakes.

After qualifying the buyer, the broker-associate has one more step to complete before showing properties.

## PREPARING THE BUYER TO BUY

The successful broker-associate will prepare the buyer for signing the contract long before the right property is found. After qualifying the buyer's needs, the broker-associate should give the

buyer a copy of the contract for purchase and sale and explain the more important paragraphs to the buyer. This serves two important functions:

- If the buyer receives important information from the broker-associate at their first meeting, this works to cement the buyer's loyalty to the associate.
- Because the buyer is given a copy of the contract along with an explanation, the contract becomes the buyer's property. When the buyer becomes interested in a particular property, the buyer is not startled when the broker-associate pulls out a contract form.

Many successful broker-associates keep a contract on a clipboard along with the MLS information on the property. It's always in sight so the buyer can review it. If the buyer asks questions like, "Can the seller leave the draperies?" the broker-associate would ask, "Should I put that in the agreement?" while writing on the contract.

## SHOWING THE PROPERTY

Once the buyer has been qualified and signed a buyer representation agreement, it is time to show properties that meet the buyer's needs. The broker-associate should use the following sequence in the showing and contracting process:

1. Setting the appointment
2. Previewing the properties (optional)
3. Planning the route
4. Entering and showing the properties
5. Evaluating the buyer's level of interest
6. Estimating the buyer's costs and making required disclosures
7. Writing the contract

Steps 1 through 5 are discussed in the following sections. Steps 6 and 7 are discussed in the Appendix.

### Setting the Appointment

This step is important not only for the obvious reason (nothing can happen until a meeting occurs) but also from a timing standpoint. Does the broker-associate set the appointment before previewing prospective homes or after? With our current technology, buyers select what they want to see based on pictures and video of the home's interior and exterior. The broker-associate doesn't often show properties that the buyer doesn't like. If a property is in poor condition, the buyer can readily see that and will not elect to see it.

It is important to keep in contact with the buyer regularly, based on priority status. At least weekly, the broker-associate should match the buyer's profile with new listings, then call the buyer for an appointment. If the broker-associate wants a Saturday showing appointment, the appointment must be made far enough in advance that the buyer can make the necessary arrangements. Saturday morning is too late to make the call. Early in the week is the best time to call for weekend showing appointments.

The best way to match a buyer with property is to use their specific property criteria to set up an email in the local MLS that sends them properties that meet their criteria daily. Buyers can indicate which properties they want to see from inside the system, and the licensee can then schedule showings on those specific homes. If the broker-associate does not have access to a computer, it is simple to enter the buyer information onto prospect cards. Spread out

the cards on a tabletop and group them by price range when reviewing new listings. Listings should be matched to the buyer, and the broker-associate should call or email the buyer regularly about properties that match the buyer's needs. The more frequently the broker-associate makes the buyer aware that she is continually searching for the right property for the buyer, the more confident and comfortable the buyer will be with the broker-associate and the buying process.

## Previewing the Properties

The broker-associate should **preview properties** before actually showing them to the buyers. The MLS system will often show a large number of properties that appear to meet the buyer's criteria. After previewing all the properties it often turns out that only three or four will really work for the buyer. Another advantage to previewing is that the licensee can walk very quickly through a property to determine if it will work. Either out of courtesy to the homeowner or out of general interest in viewing homes, buyers take more time to view even the properties they know immediately they don't like. Previewing saves time for both the broker and the buyer. Additionally, it saves the broker-associate the surprise and embarrassment of telling the buyers, "I think you'll like this next one!" only to find the property in terrible condition. The technology available currently mostly makes this unnecessary.

Each time the broker-associate sees a new property, whether on a showing appointment, a preview day, or an office caravan of new listings, the broker-associate should match that property with a buyer, taking careful notes before contacting the appropriate buyer.

## Being Prepared to Show Properties

One of the most important factors in closing the sale is being prepared. That means having the objective firmly in mind that *today* you will write the contract. So, before showing property, you should have the following in your file folder:

- A copy of the lender's preapproval letter for the top price the buyer can qualify for, so you're ready to write the buyer's offer
- All the necessary forms, including the contract for sale and purchase

## Planning the Route

Normally, the broker-associate should show no more than five properties in one tour. However, if a Priority 1 buyer is in town for the weekend for the purpose of buying a home, the broker-associate must continue to show homes or risk losing the buyer.

When setting the appointment to show properties, the broker-associate must consider in which order the homes will be shown. Buyers go through a continual evaluation process during the inspection tour, and the broker-associate should help that process. Many broker-associates like to schedule the home they consider just the right property as the last on the tour. While there are good arguments for this procedure, there are also disadvantages. The biggest problem is that if the houses get better between numbers one and five, and five is the best, the buyer wants to see house number six. Most brokers recommend showing the best house early in the tour. This sets a standard against which all other homes are measured. It usually makes the tour faster because the buyers can decide quickly that the home shown earlier was more to their liking.

Once the route has been decided, the broker-associate should make appointments for the showings with the listing brokerage firm or showing service. The time scheduled for each showing should not be fixed but should fall in a range, because it is often difficult for the broker-associate to judge how long the buyer will stay in each home on the tour. When calling the listing brokerage firm to set the showing, give them a time range of one to two hours. They will then set the showing and call all information back to the buyer's broker-associate's office. The seller will be asked to vacate the property during the showing. This allows the buyer to relax and take "emotional possession" of the property during the showing. The broker-associate should take careful notes about the location of lockboxes and whether there are any pets. If the broker-associate will be later than scheduled or must cancel, common courtesy as a professional dictates that the broker-associate should call the listing company to explain the circumstances. This can often be done using an app on your device versus making a call. Nothing is more disappointing to a seller than to needlessly prepare the home for a showing.

The route taken on the way to each property also is important. A trip past a beautiful park nearby makes the home site more interesting to the buyer, as does a trip past the shopping areas and schools closest to the home. While the initial route might avoid unsightly areas, they should be shown on the way out. Failure to show such surroundings is misrepresentation.

Oftentimes, the buyer will follow in their car rather than ride with the licensee. Once in the property, if it has negative features, the licensee should discuss those features upon arrival to reduce the shock the buyer might feel when entering. Often, the buyer defends the property: "Considering everything, the house is surprisingly clean!"

The broker-associate should avoid exaggerating a home's positive aspects to the buyer. This exaggeration may create an expectation that the house may not be able to meet. It is better that the buyer be pleasantly surprised when discovering the features.

## Entering and Showing the Properties

This process depends on a property's general appearance. If the home's exterior is outstanding, the presentation should give the buyer time to appreciate this feature. Many broker-associates park across the street so that a buyer's walk to a house is as pleasant as possible.

When highlighting a property's features, the broker-associate must remember the most important words in any sales presentation:

- Fact
- Bridge
- Benefit
- Picture

The broker-associate often points out facts that may be important to the buyer and expects the buyer to be able to translate each fact into a benefit. "This house is on a cul-de-sac" might be a typical comment when driving up to the property. The broker-associate believes this is important information to the buyer. The buyer might be thinking, "Yes, that's quite obvious. So what?" The full presentation should include fact, bridge, benefit, and picture.

The *fact* is that the property is on the cul-de-sac. The *bridge* might be "What that means to you, Mr. and Mrs. Perez..." The *benefit* is the rest of the sentence: "is that because there is no through-traffic, automobiles travel very slowly, resulting in greater safety to your children."

The *picture* is a word picture: “Imagine being out here on the street while your children roller skate safely.”



#### FOR EXAMPLE

Picture a house that you have been in recently. Try to think of as many features of the house as you can, then express those features to represent fact, bridge, benefit, and picture statements.

Or, with a group of people, set up a contest to see who can come up with the most fact-bridge-benefit-picture statements about a house that is familiar to all of you.

The broker-associate should practice this technique whenever possible: when driving in the car alone, when previewing properties, or when on the office caravan of listings. Once it becomes a habit, buyers will find the broker-associate’s statements clearer and more interesting, and the broker-associate will make more sales.

Many times, the listing office gives out the key to the back door or the back door key may be the only key provided in the lockbox, or keysafe, at the house. Although the broker-associate must go in through the door for which the broker has a key, the buyer always should enter through the front door.

Finally, the broker-associate should not overshadow a property. The buyer should be allowed to discover some of the best features on his own. The classic example of overshadowing is walking through a property making statements such as, “This is the dining room.”

## Making the Buyers’ Decision Easier

Normally, a broker-associate will only show five homes during a showing appointment. This is usually recommended so that the buyer can have an opportunity to give feedback and not become confused by a large number of homes. In some cases, however, many homes are shown to a buyer during one appointment. This might happen if the buyer is making a trip from out of town and needs to find the right house during this trip.

If a buyer sees 20 to 30 homes in a tour, the buyer will certainly be confused about which home had what feature. To make it easier, an experienced associate will have the buyer make a decision after seeing each home. You would say, “Which home do you like best—this house or the house on Cherry Lane?” If the answer is “Cherry Lane,” you would say, “okay, forget all the other homes.” At the last home on the tour, it is then easy to close with the question, “Well, which home do you want to buy, this one or the one on Cherry Lane?”

If you show more homes the next day and the buyer liked Cherry Lane best, start the tour by taking the buyer back to Cherry Lane, with a comment such as, “Okay, so this is the house we’re ready to buy if we don’t find one better today, right?”

## Evaluating the Buyer’s Level of Interest

A buyer usually knows if he is not interested in a house shortly after entering. The broker-associate should stop showing the property and proceed to the next. Because this is not the right house, it would be pointless to answer any of the buyer’s objections. If the seller is at home, the broker-associate should explain tactfully that the house does not satisfy the buyer’s needs.



## Handling Objections

Some important points to remember about objections include the following:

- An objection can be an opportunity to make the sale. Many objections can be turned into immediate selling points. “The house needs paint” could provoke an argument from an unprofessional broker-associate. The empathetic broker-associate simply asks, “Would you paint it yourself or would you hire someone to paint it for you?” With a positive response from the buyer, both parties are happy.
- Be certain you understand the objection; then, restate it. For example, a buyer may say, “This house costs too much money!” You may follow with a question such as, “If I understand you, you feel that the house is overpriced?” The buyer may answer, “No, I’m just not certain I want to buy a house at this price level.” By clarifying with a question, you avoid being argumentative.

Don’t answer an objection until you have isolated it; if there are many more objections, this is not a suitable property. “If it were not for the problem about the price, would you buy this house?” An answer of “yes” tells you, “Satisfy me regarding this problem and I’ll buy.”

If you don’t feel you can answer an objection to the buyer’s satisfaction, especially if the objection is valid and you believe it is a dealbreaker, you shouldn’t. You should agree with the buyer and go to the next property.

Make a list of as many objections as you can think of, then write out at least two plausible answers to the objection. Try them in your office sales meetings and practice them regularly.

The Appendix the legal document called a contract for sale and purchase. It is important for licensees to understand the wording of the agreement they will ask buyers and sellers to sign. The Appendix also writing and presenting an offer.

## SUMMARY

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When working with a buyer, a broker-associate must be certain to make required agency disclosures on a timely basis. A buyer benefits most when a licensee represents the buyer and no one else. Extensive product knowledge is necessary if a broker-associate is to provide the best service to a consumer. The broker-associate has many ways to acquire product knowledge, but all consist of looking at properties. Index cards or client contact software can help the licensee remember properties, and a best-buys-on-the-market list helps the broker-associate better exhibit product knowledge.

Broker-associates draw buyers from a number of sources: calls on ads or signs, past customers or clients, friends and family, open house visitors, canvassing, and buyer seminars. When handling a call about an ad or a sign, a licensee’s primary objective is to get an appointment. Broker-associates should prepare carefully for ad calls, know the properties advertised, and have fallback lists.

A broker-associate should qualify a buyer’s housing objectives and have the buyers preapproved for a loan, as well as prioritize buyers based on the immediacy of their needs. When showing properties, the broker-associate should describe benefits and be careful not to overshadow the properties. The broker-associate can help reduce buyer confusion by helping the buyer decide which is the favored house after each house is shown.



# UNIT 7

## Sales and Option Contracts

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Discuss the unique features of a real estate contract.
- › Define what is meant by a valid contract.
- › Distinguish between an implied contract and an express contract.
- › Distinguish between a voidable contract and a void contract.
- › Explain the statute of frauds.
- › Name and explain at least 10 important sections or provisions in a real estate sales contract.
- › Complete a sales contract.
- › List the requirements for completing an option contract.

### KEY TERMS

abstract  
bilateral contract  
Contract to Buy and Sell  
contract  
executed contract  
executory contract  
exercised

express contract  
implied contract  
negotiable  
option contract  
performance  
sales contract  
statute of frauds

time is of the essence  
unilateral contract  
valid contract  
voidable contract  
void contract

### OVERVIEW

Contracts are part of our everyday lives. When a person orders telephone service, buys a refrigerator, or pays for an airline ticket, a contract has been formed.

Licensees regularly work with many kinds of contracts. The broker's employment agreement, listing contracts, buyer brokerage agreements, leases, options, and sales contracts are just a few. Understanding the information in a contract and being able to correctly explain it to sellers

and buyers is an important function of a sales associate. Licensees may legally prepare listing contracts, sales contracts, and option contracts.

## ANALYSIS OF REAL ESTATE CONTRACTS

A **contract** is a promise or set of promises that must be performed. Once the promise is given, the law recognizes performance of that promise as a duty. If the promise is broken or breached, the law provides a legal remedy for the injured party. However, one promise, standing alone, does not constitute a contract. Some specific act by the party to whom the promise is made, or a mutual promise from that party, is required to conclude a contract. For example, if you promise to fix your neighbor's roof and the neighbor thanks you, no contract exists because you asked for nothing in return for your promise. If your neighbor promises to give you \$1,000 to fix his roof and you promise to do it, mutual promises have been exchanged, and a contract has been made.

### Types and Legal Standings of Contracts

Several contract types and classifications exist, each having certain legal effects. Newly licensed sales associates will remember having been exposed to certain classifications of contracts and to the fact that a contract can change from one classification to another as **performance** progresses.

A **bilateral contract**, the most common type, is a mutual agreement by both sides to perform. A real estate sales contract is an example of a bilateral contract because the seller promises to sell a parcel of real property and to deliver title, and the buyer promises to pay a certain sum of money for the property. A **unilateral contract**, on the other hand, is a one-sided promise. One party makes an obligation to perform without receiving a promise to perform from the other party. In effect, it is an offer that can be accepted only by performance on the terms offered. An example of a unilateral contract is the ordinary option, in which the person granting the option (optionor) is obligated not to sell to anyone but the person asking for the option (optionee) during the life of the option. The optionee is not required to buy. Two additional examples of a unilateral contract are

- an open listing agreement, where the seller agrees to pay a commission if the broker performs, but the broker makes no promises to market the property; and
- a broker's promise to pay a \$5,000 bonus to the broker-associate who sells the most homes in a subdivision.

An **express contract** is a mutual agreement between parties that is stated in words, either oral or written. An **implied contract** is an unwritten agreement inferred from the actions or conduct of the parties that show intent to be bound by the agreement. For example, if a broker personally buys property on behalf of his principal, a promise is implied on the broker's part to deliver the property to the principal. A second example of an implied contract is a situation in which a broker tells a seller that there is a buyer willing and able to pay for the seller's property, and the seller accepts the buyer's offer. The law usually requires that the seller pay the broker a typical rate of commission because of the parties' acts.

An **executory contract** is an agreement in which some future act remains to be done by one or both parties. For example, a real estate sales contract, between signing and title closing, is an executory contract. An **executed contract**, on the other hand, is an agreement in which the parties have fulfilled their promises and thus performed the contract. For example, a sales contract becomes an executed agreement after title closing and after all parties have fully performed. (**Note:** Do not confuse the term *executed contract* with the use of the word *execute*, which refers to the signing of a legal document such as a contract.)

A **valid contract** is an agreement that contains all of the essential elements—contractual capacity, offer and acceptance, lawful purpose, in writing and signed, and consideration (COLIC)—and is binding and enforceable on both parties in a court of law.

A **voidable contract** is an agreement that appears to be valid and enforceable but may be rescinded by one of the parties. For example, an agreement entered into with a minor usually is voidable by the minor. The competent parties element of a valid contract is absent. For another example, a contract may contain a clause (provision) related to time of performance by both parties. If either party fails to perform on or before a specified date, the other party has the right to void or nullify the contract. Thus, a voidable contract may be seen as midway between a valid contract and a void contract: it remains valid until the party with the power to void the agreement chooses to do so. A **void contract** is an agreement that is unenforceable under the law. It has no legal force because it does not contain the essential elements of a contract. For example, a listing contract in which a broker agrees to illegal discrimination based on race, sex, color, religion, national origin, family status, or handicap probably voids the document.



#### FOR EXAMPLE

You are a broker-associate who has listed Frank Wilder's home in Foxcroft. Frank would rather not repair several property defects (such as a cracked foundation). He suggests the use of an as-is clause in the contract so that a buyer can do any inspection desired. "Based on this clause," Frank tells you, "we have no need to disclose."

Does the use of an as-is clause in a sales contract excuse a broker from disclosing material facts regarding a property? Explain.

### Statute of Frauds

Before the enactment of the **statute of frauds**, it was not uncommon for a person to pay "witnesses" to falsify testimony to support a nonexistent oral contract for the sale of real property. The law commonly called the statute of frauds requires that certain types of contracts, in order to be enforceable in court, be in writing and be signed by the party against whom enforcement is sought. Contracts that must be in writing and signed are of two general types: those that will not be performed fully within a short period of time and those that deal with specific subjects.

In Colorado, an agreement to sell or the actual sale of any interest in real property is subject to the statute of frauds and must be in writing and signed by all parties bound by the contract to be enforceable. Witnesses are not required. The exception to the statute of frauds is a lease of less than 12 months.

## SALES CONTRACTS

A **sales contract**, also called a **Contract to Buy and Sell** (CBS), is a written agreement setting forth the terms for the transfer of real property from the seller to the buyer, with both signing the document. Broker-associates in Colorado must use the form developed and approved by the Colorado Real Estate Commission. This section of the unit presents specific instructions for the correct preparation of that contract, providing licensees with hands-on practice in preparing contracts to increase their professional skills. Your company training, employing broker, or mentor will also teach you how to properly prepare a contract to buy and sell.

## Completing the Contract to Buy and Sell

No two real estate transactions are exactly alike. Even two nearly identical houses located adjacent to one another may require different contractual handling. The earnest money deposits, mortgage sources, and prices, as well as many other items, must be considered. Even the tried-and-proven clauses in the approved form may need to be adapted to the requirements of a particular transaction. Therefore, licensees should use great care when completing all contracts.

## Responsibility for Preparation

The sales contract is the most important instrument for closing a real estate transaction. Because it is the final agreement after all the offers and negotiations that have taken place, a licensee must be very careful when preparing it. Any time a licensee is not certain whether an attorney is required in preparing any special clause or type of contract, the best course of action is to advise the buyer and seller to consult an experienced real estate attorney.

The broker-associate and the employing broker may be held financially responsible for any mistakes in the agreement. If any errors, omissions, or ambiguities exist regarding material terms, the courts will not go outside the contents of the contract to determine intent. The licensee who prepared the contract will not be allowed to explain later intent not indicated in the contract contents. If the contract is vague and unenforceable, the result could be no transaction at all, loss of commission, and a possible civil lawsuit against the licensee.

## “Time Is of the Essence” Provision

A single sentence in Paragraph 21, “**Time is of the essence** for all provisions of this Contract,” has important legal effects. If a party fails to perform the duties or promises made within the exact time limits in the contract, it causes an automatic default. This default then creates a right of cancellation on the part of the other party (voidable contract). Because of the importance of meeting requirements with dates and times, licensees should

- use realistic time periods,
- check that the time periods complement and are consistent with times in other blank spaces, and
- use the date and deadline chart in Section 2c to monitor performance by the parties to the sales contract once it has been signed.

## Gathering Contract Data

Collecting the information required to complete all of the entry blanks in the CBS is a sizable task. Information may become available or should be obtained as the real estate licensee helps negotiate the contract. Once the licensee gathers all of the information, he must verify it for accuracy and currency. Including obsolete information in a contract may be more harmful to a successful closing than having insufficient information to complete the contract. The licensee should pay particular attention to and be sure to verify the following two categories of data:

- *The owner/seller’s name and address and the property’s legal description.* MLS data, property appraiser information, and listing agreements have been in error on occasion. The listing broker should supply the legal description and should place more reliance on an existing or prior title insurance policy, deed, or survey for the information.

- *Financial information.* Financial data tends to change frequently and require last-minute updating. Check with the buyer's lender to make certain that the times allowed for obtaining financial commitments are realistic and that the rates and terms contemplated actually are available.

The broker-associate representing the buyer should have a conversation with the listing broker before writing the offer to make sure he has the most current disclosures and to determine certain dates and times. It doesn't make sense to have an offer countered over the closing or acceptance date if these could have been determined in an initial conversation.

## OPTION CONTRACTS

An **option contract** is a contract between a property owner (optionor) and another individual (optionee) in which the optionee, for a consideration, has the right (not the obligation) to purchase or lease the property at a specified price during a designated period. To be enforceable, an option must contain all of the essential elements of a contract.

Strictly speaking, it is important to distinguish between an *option contract* and an *option* (in actual practice the terms are often used interchangeably). If you offer to sell your house to a friend for \$100,000 and your friend wants to think about the offer for a day or so, your friend might have an option but does not have an option contract. Therefore, you could revoke your offer to sell and no breach of contract would occur because no contract exists when there is a lack of consideration (exchange of promises). Had your friend paid you \$1,000 in option money in consideration of a 30-day or 60-day period to decide about your offer and you agreed to those terms, an option contract would have been concluded. The option money given legally may be applied as part of the purchase price in the event the option is **exercised**.

An option creates a contractual right; it does not create an estate in the optioned property. When first written and executed, an option contract is unilateral. The owner/optionor is obligated to sell if given proper notice by the buyer/optionee, but the buyer/optionee is not obligated to purchase and may allow the option to expire. Options frequently are used to give a developer or buyer time to resolve problems related to financing, zoning, title, or feasibility before committing to purchase or lease. Options also are useful instruments in the land assemblage process.

In addition to the required information in an option contract, other provisions should or may be included. For example, a statement of the method of notice required to exercise the option is normally provided. Also, a provision should be included concerning the option money (the consideration) if the option is not exercised. Unless expressly prohibited by the wording of the terms, an option is usually assignable.

Option contracts often are written with less care and attention than they deserve. Keep in mind that an option contract is converted into a sales contract when the option is exercised. However, if the option fails to include all the terms material to the transaction and leaves some terms or decisions for future agreement, the option contract normally is not enforceable. For example, if the option calls for a purchase-money mortgage as part of the method of payment and does not include the mortgage interest rate or the duration, courts would typically refuse to enforce the contract. Generally, it pays to have a competent real estate attorney construct an option agreement.

**FOR EXAMPLE**

Oscar paid Silvio \$2,000 for a 30-day option to buy Silvio's house for \$160,000. Two weeks later, Silvio sold his house to Brenda for \$175,000.

Can Oscar enforce his option and require the property to be sold to him? Why or why not?

The optionee may wish to record the option. This establishes the optionee's rights back to the option date and gives priority over subsequent rights of third parties. Good title practice requires that a release of option be recorded later in the event a recorded option is not exercised. Otherwise, the expired option may create a cloud on the title. Many times, an option is constructed to include a defeasance clause stating that the recorded option will automatically cease to be a lien on the property upon expiration of the exercise date.

## SUMMARY

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A contract is a legally enforceable agreement that can be classified in a number of ways, such as bilateral, unilateral, express, implied, executory, executed, quasi, voidable, and void. Each classification has specific legal effects in a court of law. The licensee is permitted to prepare three types of real estate contracts: listing, sales, and option contracts. A sales contract is an agreement for the sale and purchase of real property. The various provisions and standards contained in a sales contract include information on the parties to the agreement, a legal description of the property, the purchase price and method of payment, deadline times and dates, information about financing, and riders to the contract.



# UNIT 8

## Writing and Presenting the Offer

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Prepare and explain a buyer's cost disclosure.
- › Write a contract for sale and purchase and be able to explain it in easy-to-understand language.
- › List the steps involved in presenting an offer.
- › List the three possible seller responses to an offer.
- › Prepare a counteroffer using information provided to you.
- › Describe the process involved when a seller makes a counteroffer.

### KEY TERM

counteroffer

### OVERVIEW

Licensees hope that at the end of the showing process, the buyers will have found a house to buy. Sometimes the buyers will tell the licensee, "This is the house; we'd like to make an offer." More often a buyer will say, "This is our favorite so far, but we'd like to think it over." The professional licensee can help the buyer make the decision by providing the buyer with information about financing, closing costs, and the process involved in making an offer. This unit will help broker-associates become familiar with that process.

### ESTIMATING THE BUYER'S COSTS AND MAKING REQUIRED DISCLOSURES

Most buyers are reluctant to make a buying decision until they see cash required to close and the monthly payment amount. To move the buyer closer to buying, the licensee should give the buyer a cost disclosure statement. The licensee should get a loan disclosure from the lender. Many broker-associates go over this disclosure during the initial meeting so the buyers know what to expect. The following exercise shows how to prepare a buyers' cost disclosure.

**FOR EXAMPLE**

Using the blank form in Figure 8.1, estimate the buyer's closing costs and monthly payments based on the following information:

Purchaser	Kyle and Kari Burton
Property address	1460 Lime Drive Denver, CO
Date of contract	March 20, 2007
Mortgage lender	Security First
Prepared by	(Your name)
Sales price	\$200,000
First mortgage:	\$160,000

**Closing costs:**

Mortgagee title insurance policy	\$400
Origination fee	1%
Discount points	½
Documentary fee (0.01 per \$100)	\$20
Recording fees	\$60
Credit report	\$50
Appraisal fee	\$300
Survey	\$180
Underwriting fee	\$125
Express mail fee	\$20
Attorney's fee	\$300

**Escrow/prepaid items:**

Taxes (3 months)	\$600
Hazard insurance (1 year)	\$900
Hazard insurance (2 months)	\$150
Monthly mortgage insurance premium (2 months)	\$44
Prepaid interest (1 month)	\$935

The buyers will give a deposit of \$4,000. The principal and interest on the 7%, 30-year, fixed-rate loan amount is \$1,064.48.

**Figure 8.1: Buyer's Estimated Closing Costs**

PURCHASER: \_\_\_\_\_ PROPERTY ADDRESS: \_\_\_\_\_

Date of contract: \_\_\_\_\_ Sales price \$ \_\_\_\_\_ \$ \_\_\_\_\_

Mortgage lender: \_\_\_\_\_ 1st mortgage \$ \_\_\_\_\_ + \_\_\_\_\_ \$ \_\_\_\_\_

Prepared by: \_\_\_\_\_ 2nd mortgage \$ \_\_\_\_\_ FHA MIP OR FUNDING TOTAL LOAN AMOUNT \$ \_\_\_\_\_

**Estimated down payment (1)** \$ \_\_\_\_\_

**Estimated closing costs:**

1. Title Insurance: ☐ owner's ☐ mortgagee's
2. Title insurance endorsements
3. Origination fee \_\_\_\_\_%
4. Discount points estimated \_\_\_\_\_%
5. Documentary fees
6. Recording fees
7. Credit report
8. Appraisal fee
9. Survey
10. Document preparation fee
11. Tax certificate
12. Underwriting fee
13. Express mail fee(s)
14. VA funding fee at \_\_\_\_\_%
15. Assumption fee on existing mortgage
16. Purchase of escrow account
17. Home inspection fee
18. Homeowner's warranty \_\_\_\_\_
19. Attorney's fee (if any)
20. \_\_\_\_\_
21. \_\_\_\_\_

**Total estimated closing costs (2)** \$ \_\_\_\_\_

**Estimated escrow/prepaid items:**

1. Taxes, \_\_\_\_\_ months \_\_\_\_\_
2. Hazard insurance, 1 year \_\_\_\_\_
3. Hazard insurance, 2 months \_\_\_\_\_
4. First-year mortgage insurance \_\_\_\_\_
5. Mortgage insurance, 2 months \_\_\_\_\_
6. Flood insurance, 14 months \_\_\_\_\_
7. Prepaid interest \_\_\_\_\_
8. Homeowners association dues \_\_\_\_\_

**Total estimated escrow/prepaid items (3)** \$ \_\_\_\_\_

**ESTIMATED MONTHLY PAYMENTS**

☐ Fixed ☐ ARM \_\_\_\_\_ % Interest rate \_\_\_\_\_ Years

Principal & interest \$ \_\_\_\_\_

Property taxes \_\_\_\_\_

Hazard insurance \_\_\_\_\_

Mortgage insurance \_\_\_\_\_

Other \_\_\_\_\_

TOTAL \$ \_\_\_\_\_

Other association fees may be due monthly

Total lines 1, 2, and 3 \$ \_\_\_\_\_

Less: earnest money deposit \$ \_\_\_\_\_

Estimated total due at closing \$ \_\_\_\_\_  
(Must be good funds)

## WRITING THE REAL ESTATE CONTRACT

In the following case study, you will complete the cost disclosure forms and the contract. You are a broker-associate for Sunny Hills Realty, Inc. In March of this year, a past customer referred Bob and Sandy Smith to you. At your request, they visited Security Atlantic Mortgage Company, which preapproved them for a mortgage loan of up to \$200,000.



### FOR EXAMPLE

After the disclosure has been completed, role play with two other people: two playing Mr. and Mrs. Smith and one playing the broker-associate. The broker-associate should present the completed form to the buyers, who should ask some simple questions in a positive way.

You learn that they want a three- or four-bedroom home with two baths and a two-car garage. They want a home in the northeast, less than five miles from the regional hospital where Bob is a pharmacist.

You describe the entire process of buying a home, from showing homes through moving into their new home. You tell them it is a sellers' market, and that listings sell almost as soon as they go on the market.

You explain the lender's good-faith estimate with them and discuss the important clauses in the purchase agreement. You give them copies of the paperwork along with a transaction broker notice. Because they have enough cash for a 20% down payment (80% loan), you can show homes in the \$250,000 range ( $\$200,000 \div 0.80$ ).

## Finding the Right Home

You set a showing appointment for Saturday and begin previewing homes that might satisfy their requirements. You find five houses that seem like real possibilities; one of them is just about perfect. It is located at 816 Harrison Court, a quiet street in a well-kept neighborhood, just two miles from the hospital. The owners have kept the home in wonderful condition. And it has great curb appeal. The home is listed by Blue Sky Realty, Inc., and is priced at \$255,000. Perfect! You make appointments to show the homes.

On Saturday morning, you show your favorite home first. Bob and Sandy love everything about it. You give them a copy of the seller's property disclosure statement, square footage disclosure, and lead-based paint disclosure that were available on the kitchen counter. The home has no apparent problems. It doesn't take long to walk through the remaining houses because they are more interested in the first home. You suggest a return visit and clear it with the listing company, who calls the sellers and then tells you the sellers are going out for several hours and the house will be available most of the day. After returning to the home, you stay unobtrusive and let the Smiths discover more features of the home. They want to think it over. You cover the market conditions with them again and explain that if they love it, it is likely that other buyers will, too.

## Writing the Offer

You suggest that, even if they end up "sleeping" on the decision, it might be helpful if they had the contract filled out. Bob says to make the paperwork out as if they were paying \$245,000. Bob wants to see the backyard again, so you suggest they look around some more while you complete the paperwork.

The sellers have requested an earnest money deposit of \$5,000. Based on previous conversations, the Smiths will want to be in the home in 20 days. Because the sellers are in town, and because the market is so active, you will give them until 10:00 pm tonight to accept or reject the offer.

You call the listing broker to confirm that the time for acceptance and closing will work. The listing broker states that the time frame is fine if you get the offer by 1:00 pm today, but that seller will need 30 days to close. The two of you verify that all the other information you need is in the Let's Make a Deal package that you picked up on the property.

The package shows the following information:

Sellers' names: Larry and Wilma Palmer

Street address: 816 Harrison Court, Sunny Hills, CO

Legal description: Lot 18, Block C, Old Hills as recorded in book 126, page 368, Lake County

Title company: J.P. Title Company, Inc.

Earnest money: \$5,000 made payable to the title company

Personal property included: range, draperies, rods, and window treatments

Also in the package are the following forms:

- Seller's property disclosure form
- Lead-based paint disclosure form
- Square footage disclosure form

The buyers also want to include the refrigerator, the washer and dryer, and the riding lawn mower. You explain that these items are not included in the sale, but they want to try for them anyway.

**FOR EXAMPLE** Preparing the Cost Disclosure Statement

Using the Buyer's Estimated Closing Costs form on the following page, estimate the buyers' closing costs and monthly payments based on the following information from a Loan Estimate given to the buyers by Security Atlantic Mortgage Co.:

**Closing costs:**

Mortgagee title insurance policy	\$ 400
Origination fee	1%
Discount points	$\frac{1}{2}$
Documentary fee	\$24.50
Recording fees	\$60
Credit report	\$50
Appraisal fee	\$350
Survey	\$250
Underwriting fee	\$125
Express mail fee	\$20
Attorney's fee	\$300

**Escrow/prepaid items:**

Taxes (3 months)	\$800
Hazard insurance (1 year)	\$1,200
Hazard insurance (2 months)	\$200
Monthly mortgage insurance premium (2 months)	\$52
Prepaid interest (1 month)	?

The principal and interest on the 6%, 30-year, fixed-rate \$200,000 loan amount is \$1,199.10.

**Figure 8.2: Buyer's Estimated Closing Costs**

PURCHASER: \_\_\_\_\_ PROPERTY ADDRESS: \_\_\_\_\_

Date of contract: \_\_\_\_\_ Sales price \$ \_\_\_\_\_ \$ \_\_\_\_\_

Mortgage lender: \_\_\_\_\_ 1st mortgage \$ \_\_\_\_\_ + \_\_\_\_\_ \$ \_\_\_\_\_

Prepared by: \_\_\_\_\_ 2nd mortgage \$ \_\_\_\_\_ FHA MIP OR FUNDING TOTAL LOAN AMOUNT

\$ \_\_\_\_\_

**Estimated down payment (1)** \$ \_\_\_\_\_

**Estimated closing costs:**

1. Title Insurance: ☐ owner's ☐ mortgagee's
2. Title insurance endorsements
3. Origination fee \_\_\_\_\_%
4. Discount points estimated \_\_\_\_\_%
5. Documentary fees
6. Recording fees
7. Credit report
8. Appraisal fee
9. Survey
10. Document preparation fee
11. Tax certificate
12. Underwriting fee
13. Express mail fee(s)
14. VA funding fee at \_\_\_\_\_%
15. Assumption fee on existing mortgage
16. Purchase of escrow account
17. Home inspection fee
18. Homeowner's warranty \_\_\_\_\_
19. Attorney's fee (if any)
20. \_\_\_\_\_
21. \_\_\_\_\_

**Total estimated closing costs (2)** \$ \_\_\_\_\_**Estimated escrow/prepaid items:**

1. Taxes, \_\_\_\_\_ months \_\_\_\_\_
2. Hazard insurance, 1 year \_\_\_\_\_
3. Hazard insurance, 2 months \_\_\_\_\_
4. First-year mortgage insurance \_\_\_\_\_
5. Mortgage insurance, 2 months \_\_\_\_\_
6. Flood insurance, 14 months \_\_\_\_\_
7. Prepaid interest \_\_\_\_\_
8. Homeowners association dues \_\_\_\_\_

**Total estimated escrow/prepaid items (3)** \$ \_\_\_\_\_**ESTIMATED MONTHLY PAYMENTS**

☐ Fixed ☐ ARM \_\_\_\_\_ % Interest rate \_\_\_\_\_ Years

Principal & interest \$ \_\_\_\_\_

Property taxes \_\_\_\_\_

Hazard insurance \_\_\_\_\_

Mortgage insurance \_\_\_\_\_

Other \_\_\_\_\_

TOTAL \$ \_\_\_\_\_

Other association fees may be due monthly

Total lines 1, 2, and 3 \$ \_\_\_\_\_

Less: earnest money deposit \$ \_\_\_\_\_

Estimated total due at closing \$ \_\_\_\_\_

(Must be good funds)

**FOR EXAMPLE** Preparing the Contract to Buy and Sell (CBS)

You will need to download and print out a copy of the current Contract to Buy and Sell for this exercise. Go to the Colorado Division of Real Estate website: [dre.colorado.gov](http://dre.colorado.gov).

Just as you are finishing the contract, Sandy and Bob return to the kitchen. You tell them it's a great home, and well-priced at \$255,000. You ask if there is anything they want to do to the home after they buy it, and Bob says he wants to pour a concrete patio. At your request, they write a short note to the sellers about why they want to buy this house and sign it.

Then you go over the contract form carefully. Sandy says it all looks good. You say, "You could go home and worry about this tonight, or I could take this to the seller and you might have great news to celebrate tonight. Wouldn't it be better if we went ahead?" Wait for the answer—in many cases, the buyer will agree.

If the Smiths agree, ask them to approve the agreement with their signatures.

Ask for the earnest money deposit and clip all the paperwork together along with the lender letter stating that they can qualify for the home. To prepare them for a counteroffer, ask that they not be too disappointed if the seller does not accept the offer at \$245,000. After dropping them off, you should immediately contact the listing agent, Hillary Jenkins, to let her know you have a signed offer.

**Presenting the Offer**

Hillary answers her mobile phone right away. After you tell her that you have the offer signed, she asks if you'd like to email her the offer. You ask if there are any other offers to be presented, and she says there are not. You request that you be called if that situation changes, and she agrees.

Hillary calls back and says she has an appointment with the Palmers at 7:00 pm.

**Sellers' Responses to an Offer**

Sellers who receive an offer on their home have several possible responses:

- Acceptance
- Rejection
- Counteroffer

**Acceptance**

Obviously, the buyer's broker-associate hopes the response will be an acceptance. In this case the offer is signed and becomes a contract between the buyer and the seller.



## Rejection

If the price offered is very low and is obviously a “fishing expedition,” the seller may be advised to reject the offer outright. A better approach might be to reject the offer with an invitation to come back with a more serious offer. In a strong sellers’ market with many buyers bidding for the same properties, brokers report that sellers often reject offers unless they are very close to the asking price.

## Counteroffer

If the offer is not acceptable but is close enough to be considered serious, a **counteroffer** should be used. A counteroffer keeps the parties “at the table,” making continued negotiations easier.

The approved Colorado Counterproposal form must be used when countering an offer. The form is used only to note the changes to the original offer and must be attached to the offer to be valid. The earnest money is also still attached to these documents. Earnest money is not deposited until the offer is accepted.

**Remember:** The seller will just initial the box in the CBS marked “counter” and will *not* sign the offer but will sign the Counterproposal.

In 15 minutes, Hillary comes to the door and motions you inside. Back at the table, Hillary says, “Mr. and Mrs. Palmer want the Smiths to have this home, but they want to make several changes. First, they feel the house is worth the asking price of \$255,000, but they will split the difference with the buyers at a price of \$250,000. They will include the range and window treatments but want to take the other items of personal property. I have a signed counterproposal for you to take to your buyers.”

When you arrive at the Smiths’ house, you tell them you have great news. “The sellers came off the price by \$5,000! Let’s go over their counteroffer.”

They agree to all terms of the counteroffer. You change the cost disclosure statement to reflect the new price. Then you call Hillary to tell her you are under contract and ask where she would like the contract to be delivered.

You have sold the house and made several people very happy.

## Additional Points on Writing and Presenting Offers

- If the buyers’ offer is much lower than the asking price, strongly recommend that the buyers not add many contingencies to the offer. Boil all the requirements into the offering price.
- If the market is very strong and there might be multiple offers for the property, don’t add too many contingencies. Sometimes even if the offering price is good, a buyer may accept another offer that is simpler and more certain to close.
- If the market is very strong and you are aware that there will be competing offers for the property, recommend that the buyers not only remove most contingencies, but also consider making an offer that is higher than the asking price.
- Make the acceptance date fairly short so the seller makes a decision quickly, rather than waiting to “shop” the offer.
- Go with your contract. Present it with the listing agent. You may be busy, but you’ll have many more accepted contracts if you help in the presentation. You are the only one who

can answer questions about the buyers and give the buyers a “face” in the minds of the sellers. Sure, it takes more of your time. But this is top priority time, and your customers’ satisfaction (as well as lots of your money) is riding on your performance.

- If you are the listing associate and another associate has the offer, you want the cooperating associate to be with you when you present. You’re a team. It also stops second-guessing about the quality of your presentation if the other associate’s offer is not accepted. If the other associate is a buyers’ agent, you should tell your sellers not to give any reaction during the presentation of the offer, as it may affect their negotiating position.
- If you are the listing broker-associate, prepare your sellers for a low offer before the cooperating broker-associate arrives to present the offer. If the sellers have raised expectations, a low offer may insult them and make it very difficult to put a transaction together.
- If the parties are far apart on the offered price, try to keep the buyers and sellers from taking it personally. It is your job to be sure personalities are not a factor in the negotiations.
- Be courteous to the cooperating broker-associate. Nothing can derail the presentation of an offer more than distrust and dissension between the licensees.
- Don’t give the offer out to all parties until you have summarized the important parts. It is hard to maintain control if the parties are all looking at different parts of the contract and interrupting by asking questions.
- Make enough documents for everyone who will be at the presentation so they don’t have to read over your shoulder.
- Cover all points of the agreement, discussing the price last. Make sure all the buyers’ requirements depend on getting the price right.
- Work the contract until it’s either accepted or dead. Don’t stop working it because it’s nearly midnight. Sellers want to sell and buyers want to buy, and they respect professionals who work hard. Working late brings an urgency that gets lots of offers accepted.
- If you are the listing associate and the cooperating associate brings in a very low offer, have the cooperating associate present the offer to your sellers.
- If the offer is low and the sellers are angry, let them vent their frustration before starting to work on a counteroffer.
- If multiple offers are received, the listing broker should present them all at the same time.

## SUMMARY

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Because buyers are reluctant to commit to buy without understanding the financial commitment they must make, a broker-associate should understand how to prepare a cost disclosure statement. To reduce liability, the statement should be based on a lender’s good-faith estimate of settlement costs.

A licensee should practice preparing offers on different types of properties with a variety of financing programs. Once the practice offer is written, you should role play the explanation of the offer. Practice will give you the skills to help you get more transactions to the closing table.

## APPLY WHAT YOU'VE LEARNED

The following actions reinforce the material in Units 6 through 8:

- Preview at least five homes in your favorite price range. Try to see five each day for the next five days. Use a tape recorder to describe each home thoroughly and try to match it with a prospective buyer or type of buyer.
- From your preview visits, list the best homes on the market. Pick your favorite home from that list.
- Describe every characteristic of your favorite home from your preview trips as if you were writing a book on the house. Try to remember colors, room sizes and arrangements, and garage size. Describe each room in as much detail as possible. If you can't do it, go back to the house again and make careful notes. Try to increase your observation powers every time you preview homes.
- When you visit a vacant home, thoroughly describe each room aloud as if your buyer were sight-impaired.
- Keep a tape recorder near your phone. The next time you answer a call from a prospective buyer, turn on the recorder. (You must observe the law, however; record only *your* side of the conversation.) When you have completed the call, listen to the tape. Make written notes about what you would change about your side of the conversation.
- Ride through a neighborhood you have not yet explored, describing into your tape recorder the details you see. Then do the same thing in the surrounding area to find shopping areas, libraries, car washes, schools, and houses of worship.
- Write down the features you think some close friends would like in a home. From memory, list the properties you would show them and give reasons for your decisions. Make a buyer's cost statement based on a 90% conventional loan.
- Call your friends and tell them about the previous exercise. Ask whether they will let you show them the homes you chose for them. How well did you judge their tastes?



# UNIT 9

## Exploring Mortgage Alternatives

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Describe the components of the lender's required annual percentage rate (APR) disclosures.
- › Calculate the effective interest rate on 30-year, fixed-rate loans and on loans for shorter periods.
- › Calculate the PITI payment for a borrower.
- › Compare the interest savings on a 15-year, fixed-rate mortgage versus a 30-year, fixed-rate mortgage.
- › Compare the interest savings on a biweekly mortgage versus a 30-year, fixed-rate mortgage.
- › Discuss the pros and cons of an adjustable-rate mortgage (ARM).
- › Explain the five components of an ARM.
- › Explain the advantages of FHA interest rate caps over conventional ARM caps.
- › Calculate interest rate adjustments.

### KEY TERMS

adjustable-rate mortgage (ARM)	calculated interest rate cap	negative amortization
annual percentage rate (APR)	fixed-rate mortgage	PITI payment
biweekly mortgage	index	private mortgage insurance
	margin	refinancing

### OVERVIEW

The mortgage market has seen many significant changes in recent years. Twenty years ago, commercial banks and savings associations originated more than 80% of home mortgages. That share has dropped sharply, and today mortgage companies are the dominant factor in the market, originating more than 50% of all home loans. Driven by market forces, lenders offer a wide variety of mortgage products tailored to the needs of consumers. Experts expect the changes to accelerate in the future.

A general knowledge of these changes can enhance the opportunities available to the real estate professional. Developing strong relationships with lenders who preapprove loans for prospective buyers saves licensees time and can significantly increase their income.

Steps Before Loan Application

Before buyers begin calling or visiting lenders, they should have a good understanding of their own financial capabilities and housing objectives. Licensees should explain both issues to their customers to help them understand the importance of prequalifying. This is important because if a loan application is denied, the applicant may lose the opportunity to buy the desired home. In addition, some expense is involved in applying for a loan. Fees may range from \$150 to \$500, depending on the property and circumstances.

Mortgage Shopping

In shopping for a mortgage, licensees should advise buyers to look for competitive rates and a lender with a reputation for integrity and good service.

Surveys show that mortgage interest rates and closing costs vary in metropolitan markets for the same mortgage product. Comparing prices obviously is important, but it is not an easy task, as lenders charge borrowers a variety of fees to submit a loan application. Discount points, usually one of the largest fees lenders charge, also vary from lender to lender in the same market area. The points change the effective interest rate, and just two points more on a loan can mean significant additional expense to the borrower.

Licensees must learn which lenders can be trusted to act with speed and service to borrowers. Licensees should use and recommend only those that provide good service.

Seller-Paid Closing Costs

A buyer must have the necessary income and debt ratios to afford a mortgage payment. Coming up with enough cash to close is another big hurdle. The closing costs and prepayments on a typical mortgage loan for \$120,000 can reach \$5,000 in addition to the down payment. Many qualified buyers are forced to rent in order to accumulate the savings necessary to close. Licensees who know lender standards on seller-paid closing costs are able to sell to these buyers much sooner. The seller can pay part of the closing costs for conventional, FHA, and VA mortgage loans. Figure 9.1 shows the current allowed percentages.

Figure 9.1: Maximum Seller-Paid Closing Costs That Can Be Applied to Buyer’s Closing Costs, Prepaid Items, and Reserves, Expressed as a Percentage of the Purchase Price

Type of Loan	Percent
Conventional	
Less than 10% down payment	3
19% or greater down payment	6
FHA	6
VA	6

A seller who could pay only 3% of the buyer’s closing costs on a low down payment conventional loan for \$120,000 would contribute \$3,600. If a two-income family is saving \$300 per month, the home purchase could be made 12 months sooner.

**FOR EXAMPLE**

Do you think most licensees guide potential borrowers to lenders with whom they have built relationships or to lenders who have the best mortgage rates on a given day?

**Annual Percentage Rate (APR)**

The Truth in Lending Act requires that mortgage lenders disclose their annual percentage rates to potential borrowers. The **annual percentage rate (APR)** is a standard expression of credit costs designed to give potential borrowers an easy method of comparing lenders' total finance charges. These financing costs include points and any other prepaid interest or fees charged to obtain the loan, in addition to the contract interest cost. By law, the APR must be the relationship of the total financing charge to the total amount financed, and it must be computed to the nearest one-eighth of 1%. Perhaps the best and most accurate definition of the APR is that it is the effective interest rate for a mortgage loan repaid over its full term.

The law allows a lender three days after loan application to inform the applicant of the APR. When a lender gives the borrower a good-faith estimate of the annual percentage rate, the consumer should be aware that this is not a legally binding document; it is simply an estimate. Licensees should avoid lenders who frequently estimate a lower APR than the rate available at closing.

Another feature of this act is that it assumes that borrowers will keep their loans for the full number of years for which the loans are written. Records of mortgage lending, however, show that most borrowers either sell or refinance their homes in less than 12 years. The actual (effective) interest rate paid depends on the number of years a loan is kept.

**FOR EXAMPLE**

If the borrower expects to keep the loan for longer than 12 years, divide the points by 8 and add the result to the note interest rate. For Example, if a lender has offered a first mortgage for 30 years at 7.5% and 3 points, the effective interest rate would be 7.875%, computed as follows:

$$\begin{aligned}\text{note rate} + (\text{points} \div 8) &= \text{effective interest rate} \\ 7.5\% + (0.03 \div 8), \text{ or } 7.5\% + 0.375\% &= 7.875\%\end{aligned}$$

When the lender gives a prospective borrower a rate quote, the borrower is often undecided about whether to pay discount points. Discount points can be considered prepaid interest that will reduce the interest rate on the note. In effect, a borrower has a menu of interest rates based on the amount paid as discount points. Figure 9.2 shows a sample market quote for a 30-year fixed-rate loan. Fluctuations in the market cause differences from day to day in the differential of discount points and yield.

From the example, it's obvious that a person who intends to occupy the property for three years should avoid paying points because it will take almost six years to break even. In some cases, a borrower should ask the lender to raise the interest rate, not only to avoid discount points but also to avoid paying an origination fee.

**Figure 9.2: Comparison of Interest Rates and Discount Points (For a \$100,000, 30-Year, Fixed-Rate Mortgage)**

	A. Interest Rate	B. Discount Points	C. Principal and Interest Payment (\$)	D. Payment Difference from 7% Rate (\$)	E. Amount Paid in Discount Points (\$)	F. Months at Lower Rate for Points Payback (E ÷ D)
1.	7.000	0	665.30	—	0	0
2.	6.875	0.5	656.93	8.37	500	59.7
3.	6.750	1.2	648.60	16.70	1,200	71.9
4.	6.625	1.7	640.31	24.99	1,700	68.0
5.	6.500	2.3	632.07	33.23	2,300	69.2

If a person expects to remain in the property for the full 30-year period and will not be refinancing or making an early loan payoff, the savings could be worth paying points. At line 5, for instance, the borrower breaks even at 69 months. The difference in payments of \$33.23 for the remaining 291 months would total \$9,670, which is well worth paying the points.

Of course, the better way to analyze points is by considering the time value of money. Using the 6.5% rate on line 5, the borrower pays \$2,300 in today's dollars (which could be invested to return some interest) to get a savings sometime in the future. A financial calculator approach shows the payback period is longer (87 months vs. 69.2 months).

The following are the financial calculator keystrokes to find the payback period for \$2,300 in points with a 6.5% yield:

%I	PMT	PV	FV	Solve for N
0.54167	33.23	2,300	0	87 months

Where:

% = monthly market interest rate:  $6.5\% \div 12 \text{ months} = 0.54167$

PMT = savings per monthly payment =  $-\$33.23$

PV = dollars paid in points = \$2,300

FV = input zero for this problem = 0

Solve for: N = number of months to pay back points

**Solution is 87 months**



#### FOR EXAMPLE

Santiago has been transferred to Colorado Springs and expects to be in the location for about three years before being transferred again. He needs to borrow \$200,000 for his new home. With no points he can get a 7.5%, fixed-rate mortgage with principal and interest payments of \$1,398.43. The lender offers him a 7.125% mortgage (payments of \$1,347.44) with two points.

Should Santiago take the lower interest rate mortgage?

Using simple math, how many months will it take Santiago to break even by paying the points if he takes the lower interest rate?



## PITI Payment

Customers often ask licensees to calculate the monthly mortgage payment for a possible purchase or sale. Most lenders require an amount each month that includes principal and interest plus escrow items—property taxes, homeowners insurance, and possibly mortgage insurance or homeowners or condominium association dues. This entire package of payments is commonly referred to as the **PITI payment**.

Principal and interest payments on the mortgage are the largest part of the monthly PITI payment. Using the mortgage payment factor table shown in Figure 9.3, multiply the loan amount by the appropriate factor to get the principal and interest portion of the payment.

For example, the payment factor for a 30-year mortgage at 8.5% is 0.0076891. To calculate the monthly principal and interest for a 30-year loan of \$98,000 at 8.5%, use the following equation:

$$\$98,000 \times 0.0076891 = \$753.53$$

While the factor table has been included in this text to help calculate the monthly payment, most real estate licensees use a financial calculator to obtain a more accurate monthly mortgage payment of principal and interest.

In the previous example, the licensee with a financial calculator would solve the problem as shown below:

<b>N</b>	<b>%I</b>	<b>PV</b>	<b>FV</b>	<b>Solve for PMT</b>
360	0.70833	98,000	0	\$753.53

Where: N = number of monthly periods in loan term

%I = interest rate (8.5% ÷ 12 months = 0.70833)

PV = loan amount

FV = input zero when solving for present value

Solve for: PMT = monthly mortgage payment

**Note:** %I is calculated by dividing 8.5% by 12 months.

A PITI worksheet that licensees can use in helping their clients and customers calculate the PITI amount for a potential loan is shown in Figure 9.4.

**Figure 9.3: Mortgage Payment Factor Table**

Interest Rate	Term of Loan				
	10 years	15 years	20 years	25 years	30 years
5.00%	0.0106066	0.0079079	0.0065996	0.0058459	0.0053682
5.25%	0.0107292	0.0080388	0.0067384	0.0059925	0.0055220
5.50%	0.0108526	0.0081708	0.0068789	0.0061409	0.0056779
5.75%	0.0109769	0.0083041	0.0070208	0.0062911	0.0058357
6.00%	0.0111021	0.0084386	0.0071643	0.0064430	0.0059955
6.25%	0.0112280	0.0085742	0.0073093	0.0065967	0.0061572
6.50%	0.0113548	0.0087111	0.0074557	0.0067521	0.0063207
6.75%	0.0114824	0.0088491	0.0076036	0.0069091	0.0064860
7.00%	0.0116108	0.0089883	0.0077530	0.0070678	0.0066530
7.25%	0.0117401	0.0091286	0.0079038	0.0072281	0.0068218
7.50%	0.0118702	0.0092701	0.0080559	0.0073899	0.0069921
7.75%	0.0120011	0.0094128	0.0082095	0.0075533	0.0071641
8.00%	0.0121328	0.0095565	0.0083644	0.0077182	0.0073376
8.25%	0.0122653	0.0097014	0.0085207	0.0078845	0.0075127
8.50%	0.0123986	0.0098474	0.0086782	0.0080523	0.0076891
8.75%	0.0125327	0.0099945	0.0088371	0.0082214	0.0078670
9.00%	0.0126676	0.0101427	0.0089973	0.0083920	0.0080462
9.25%	0.0128033	0.0102919	0.0091587	0.0085638	0.0082268
9.50%	0.0129398	0.0104422	0.0093213	0.0087370	0.0084085
9.75%	0.0130770	0.0105936	0.0094852	0.0089114	0.0085915
10.00%	0.0132151	0.0107461	0.0096502	0.0090870	0.0087757
10.25%	0.0133539	0.0108995	0.0098164	0.0092638	0.0089610
10.50%	0.0134935	0.0110540	0.0099838	0.0094418	0.0091474
10.75%	0.0136339	0.0112095	0.0101523	0.0096209	0.0093348
11.00%	0.0137750	0.0113660	0.0103219	0.0098011	0.0095232
11.25%	0.0139169	0.0115234	0.0104926	0.0099824	0.0097126
11.50%	0.0140595	0.0116819	0.0106643	0.0101647	0.0099029
11.75%	0.0142029	0.0118413	0.0108371	0.0103480	0.0100941

**Figure 9.4: PITI Worksheet**

Mortgage amount	\$ _____	
Interest rate	_____ %	
Term of loan	_____ years	
Mortgage payment factor	_____	
Principal and interest payment:		\$ _____
(\$ _____ (mtg. amt.) _____ (factor))		
Property taxes: \$ _____ ÷ 12		_____
Hazard insurance: \$ _____ ÷ 12		_____
Mortgage insurance: \$ _____		
\$ _____ (mtg. amt.) × _____ (premium rate) ÷ 12		
TOTAL MONTHLY MORTGAGE PAYMENT (PITI)		\$ _____

## FIXED-RATE MORTGAGES

Any mortgage written to preclude change in the interest rate throughout the duration of the loan is a **fixed-rate mortgage**. The term includes the traditional 30-year mortgage, the 15-year mortgage, and the biweekly mortgage. The use of a due-on-sale clause in a fixed-rate mortgage reserves the lender's right to make an interest rate change if a transfer of ownership takes place. Practically all conventional mortgages issued since the early 1980s contain such a clause.

### Traditional 30-Year Mortgage

The fixed-rate, fully amortizing mortgage loan has been the standard of the real estate finance industry for the past 50 years. A 30-year term provides a reasonably low payment for the amount borrowed, while the interest rate, payment amount, and repayment schedule are set permanently at the beginning of the loan period. Fixed-rate loans often are sold in the secondary market because they appeal to pension funds and other investors searching for a relatively safe investment with a known interest rate and a long duration.

#### ***Advantages of a 30-Year Mortgage***

Monthly payments on the loan are spread over 30 years, offering the borrower protection against future increases in interest rates and inflation rates while providing for the orderly repayment of the amount borrowed. Household budgets are easier to manage when the borrower does not have to plan for changing payment amounts or interest rates.

#### ***Disadvantages of a 30-Year Mortgage***

If overall interest rates drop, as they did in 2000–2001, the rate on a fixed-rate mortgage will not go down with them. To take advantage of lower interest rates, the original loan must be repaid with the proceeds of a new loan taken out at the lower rate. This procedure, called **refinancing**, usually requires that the borrower pay substantial closing costs on the new loan.

## 15-Year Mortgage

The 15-year, fixed-rate mortgage has become popular with both lenders and borrowers in recent years. It is just like a traditional 30-year loan, except that its monthly payment is higher, its interest rate typically is slightly lower, and it is paid off in 15 years. The 15-year mortgage saves the borrower thousands of dollars in interest payments.

The popular press sometimes compares the two mortgage plans, showing dramatic savings from the 15-year plan. The gross savings, however, usually are overstated. The higher payments on the 15-year plan have an opportunity cost. If the difference were invested, the return on the investment would reduce the net cost of the 30-year mortgage. The tax savings from mortgage interest deductions also would reduce the savings.

For many borrowers, the 15-year mortgage may be the best way to finance a home because, in addition to the overall savings in total cost, it forces a monthly saving in the form of extra equity and allows a person who needs it a sense of confidence that the home will be paid off in 15 years. This is true for those planning in advance for retirement.

Licensees should point out, however, that the 15-year mortgage robs the borrower of some flexibility. A 15-year mortgage cannot be extended to 30 years, but a 30-year mortgage can be paid off in 15 years if the borrower accelerates monthly payments to create a 15-year loan or remits a lump-sum payment on principal each year. The borrower retains the right to decide when, or if, to make extra payments. Borrowers must evaluate the benefits of the 15-year mortgage based on their personal situations.

### ***Advantages of a 15-Year Mortgage***

Because lenders get their money back sooner than they do with traditional 30-year mortgages, they charge slightly lower rates for 15-year loans. Also, the loans are paid off faster, less money is borrowed for less time, and less total interest is paid over the lives of the loans—more than 50% less. As with a 30-year, fixed-rate loan, the interest rate on a 15-year mortgage does not change, and the monthly principal and interest payment does not go up. Finally, the higher monthly payment results in forced savings in the form of faster equity buildup.

### ***Disadvantages of a 15-Year Mortgage***

The monthly payment on a 15-year loan is higher, and the borrower forgoes investment opportunities voluntarily for the extra dollars paid on the loan each month. Some income tax advantages related to home mortgages and investment opportunities are lost. Flexibility of mortgage payment is sacrificed, and any future increase in income tax rates could increase the 15-year mortgage's net costs.

## Biweekly Mortgage

The development of computer programs to service biweekly mortgages properly, the creation of a secondary market (Fannie Mae), increased familiarity with the product, and growing consumer demand all are combining to bring about a comeback for the biweekly mortgage. The **biweekly mortgage** alternative is a fixed-rate loan, amortized over a 30-year period, with payments made every two weeks instead of every month. Borrowers pay half the normal monthly payment every two weeks, which means a total of 26 payments each year, or the equivalent of 13 monthly payments. The extra month's payment each year reduces the

principal faster and results in considerable savings in interest, as well as a reduction in the duration of the loan to between 19 and 21 years.

Normally, interest rates for biweekly mortgages are comparable to the rates charged for traditional 30-year mortgages. Most biweekly loans are scheduled to mature in 30 years even though the actual number of years to maturity depends on the interest rate. The higher the interest rate, the larger the monthly payment, and the more that is applied to reducing mortgage principal. A biweekly mortgage with a 7% interest rate, for example, would be paid off in approximately 23 years, 9 months.

*Consumer Reports* analyzed several mortgage options and concluded that a \$100,000 biweekly mortgage at 8% interest would save a borrower approximately \$34,000 in interest when compared with a traditional 30-year, fixed-rate mortgage at the same interest rate.

Figure 9.5 compares the results of making scheduled payments on a traditional 30-year mortgage, of adding different amounts of additional principal payments each month, and of making scheduled payments on a biweekly mortgage amortized over 30 years.

**Figure 9.5: Comparison of Interest Costs for Various Mortgage Plans (For a \$100,000 Loan at 8% Interest)**

Payment Pattern	Regular Payment Amount (\$)	Total Paid Each Year (\$)	Time Until Paid Off	Total Interest Paid (\$)
30-year mortgage	733.76	8,805	30 years	164,155
Added \$25/month	758.76	9,105	26 yrs. + 6 mos.	141,286
Added \$100/month	833.76	10,005	20 yrs. + 2 mos.	101,770
Biweekly mortgage	366.88	9,539	22 yrs. + 10 mos.	117,804
15-year mortgage	955.65	11,468	15 yrs.	72,017

### ***Advantages of a Biweekly Mortgage***

A biweekly mortgage combines the benefits of a 30-year loan and 15-year loan without the increased payments of the 15-year loan. It offers borrowers the affordability of the 30-year loan because the two biweekly payments come within a few pennies of the one monthly payment on a 30-year loan.

Also, Fannie Mae requires that payments be deducted automatically from a borrower's checking or savings account every two weeks. Because more than half of the nation's workforce is paid on a biweekly basis, it is compatible with a large number of paychecks. Some lenders include a conversion clause that permits a borrower to change a biweekly mortgage to a traditional 30-year, fixed-rate, amortized mortgage at little or no cost with only 30 days' advance notice.

### ***Disadvantages of a Biweekly Mortgage***

The biweekly mortgage has the same disadvantages as other fixed-rate mortgages. In addition, the biweekly loan threatens those borrowers who do not maintain stable checking or savings account balances. The biweekly mortgage also locks borrowers into payment plans that they could set up themselves, at their own discretion, with a traditional 30-year loan. Some lenders also charge a setup fee.

**FOR EXAMPLE**

If a biweekly mortgage combines the good features of both the traditional 30-year, fixed-rate mortgage and a 15-year, fixed-rate mortgage, why is it so seldom used, comparatively speaking, to finance residential purchases?

## ADJUSTABLE-RATE MORTGAGES

The **adjustable-rate mortgage (ARM)** has become a widely accepted alternative to the traditional 30-year, fixed-rate, level-payment mortgage. The popularity of ARMs noticeably increases when interest rates rise, and they lose favor when interest rates fall. An adjustable-rate mortgage is, as the term implies, a financing instrument that allows the lender to increase or decrease the interest rate based on the rise or fall of a specified index.

### Components of Adjustable-Rate Mortgages

The primary elements in determining the acceptability of an ARM from the borrower's viewpoint are the index, the lender's margin, the calculated interest rate, the initial interest rate, and the interest rate cap.

Lending institutions are legally permitted to link the interest rate of a conventional ARM to any recognized **index** (indicator of cost or value) that is not controlled by the lender and is verifiable by the borrower. The **margin**, also called the *spread*, is a percentage added to the index. The margin usually remains constant over the life of the loan, while the selected index may move up or down with fluctuations in the nation's economy. The calculated (or actual) interest rate is calculated by adding the selected index to the lender's margin (index plus margin equals calculated interest rate). This calculated interest rate may be discounted during the initial payment period, but it is the rate to which all future adjustments and caps apply.

To be competitive, lenders sometimes reduce the first year's earnings by discounting the calculated interest rate, thus creating a lower initial interest rate. This helps to qualify potential buyers at artificially low interest rates, which may or may not be a service to the borrowers, and establishes the amount of the monthly loan payment during the first time period of the loan. Be aware that many lenders now use the second year's interest rate rather than the discounted rate as the qualifier. Both Fannie Mae and Freddie Mac require borrowers with less than a 20% down payment on one-year, adjustable-rate loans to be qualified at the initial interest rate plus 2%.

The main appeal of ARM loans is the lower-than-market initial interest rates offered as inducements (teasers). But without some type of protection from unacceptable increases in interest rates, borrowers would be in danger of being unable to make future mortgage payments. To prevent this, most lenders and all federal housing agencies have established standards calling for ceilings on increases. Three types of **caps** (ceilings) limit increases in the calculated interest rates of ARM loans:

- Amount of increase that can be applied at the time of the first adjustment (for example, a cap of 1% or 2% per adjustment period)
- Amount of increase that can be applied during any one adjustment interval (for example, no more than 2% during any one-year period)
- Total amount the interest rate may be increased over the life of the loan (for example, no more than 6%)

Borrowers should be cautious when payments are capped and interest rates are not because of the probability that **negative amortization** will occur. Negative amortization occurs when the

monthly payment is not enough to pay the interest on the loan. The shortfall is added to the mortgage balance.

Lenders must provide potential borrowers with a worst-case example at loan application. This disclosure must show the maximum possible payment increases if conditions should warrant maximum interest rate increases at the earliest opportunities.

## Conventional ARM

Figure 9.6 compares two approaches to a \$100,000 conventional mortgage using a worst-case scenario for interest rate increases.

In this example, all monthly payment amounts are for principal and interest, and the amounts are rounded to the nearest dollar. The up-front costs of points and fees will be discussed later.

**Figure 9.6: \$100,000 Mortgage Loan, 30-Year Term, 8% Fixed-Rate vs. 5.5% Adjustable-Rate Mortgage (Annual Cap 2%, Lifetime Cap 6%)**

Year	Fixed Rate		Adjustable Rate		ARM Savings (Loss)	
	Payment (\$)	Rate (%)	Payment (\$)	Rate (%)	Monthly (\$)	Accumulated (\$)
1	734	8	568	5.5	166	1,992
2	734	8	699	7.5	35	2,412
3	734	8	841	9.5	(107)	1,128
4*	734	8	990	11.5	(256)	(1,944)

\*ARM savings exhausted in the fifth month of year 4.

ARM loans have lower initial rates than fixed-rate mortgages, primarily because lenders can avoid the risk of market interest changes for the full 30 years of the loan period. ARM loans reduce the risk, so lenders don't need as much cushion for contingencies. New ARM products are available that combine the ARM features of lower initial interest rate with a longer fixed-rate period between adjustments. For example, three-year, five-year, or ten-year ARMs are available at slightly higher initial rates than one-year ARMs, but at lower rates than 30-year fixed mortgages.



### FOR EXAMPLE

In your opinion, do the lower initial rates offered on ARM loans cause borrowers to take on more mortgage debt than they can afford? Why or why not?

## Interest Rates and Recognized Indexes

The index to which a conventional ARM is tied can increase or decrease the volatility of interest rate changes. There are four principal indexes used for residential mortgages:

- The LIBOR (London Interbank Offered Rate) index is the base interest rate paid on deposits between banks in the Eurodollar market.
- MTA—Monthly Treasury Bill Average—This stable, slow-moving index is a 12-month moving average of the U.S. One-Year Treasury Bill.

- COFI—11th District Cost of Funds Index—Another stable, slow-moving index, this consists of the weighted average of deposits and borrowings between banks in the Federal Home Loan Bank District of San Francisco.
- PRIME rate is the rate charged to most favored customers by major banks. This rate is commonly used for adjustments to home equity or second mortgages and can be quite volatile.

Lenders must provide consumers with details on conventional ARMs to assist them in comparison shopping. Potential borrowers must be informed of the index used, how often the loan will be adjusted, and the maximum amount of loan payment increase allowed.

When helping prospective borrowers sort through the many factors to be considered in selecting a conventional adjustable-rate loan, licensees should make sure the borrowers know

- what rate will be used when interest rate caps are applied to an ARM loan;
- that the margin is one of the most important benchmarks in comparing lenders (most other ARM features are relatively similar, but the margins can vary considerably);
- to seek another lender if the one they are considering has policies that call for ARM increases exceeding the 2% annual cap or the 6% lifetime cap;
- not to consider loans that call for negative amortization;
- to compare up-front costs, such as underwriting fees, points, and origination fees, because some lenders offer lower interest rates but make up for it with inflated up-front costs; and
- not to stretch their borrowing to the limit, as they could with a fixed-rate loan, because the payments remain fixed and income should increase. Borrowing to the limit can become a disaster when an ARM is involved. Prospective borrowers should calculate their first-year payments at the initial interest rate plus 2%; otherwise, the first adjustment could hurt them financially.

### ***Advantages of an ARM Loan***

The ARM's low initial interest rate and the borrower's ability to qualify for a larger mortgage top the list of advantages of adjustable-rate mortgages. ARMs appear to be most appropriate for those who plan to hold the mortgage loans for no more than four years. Also, any time the interest rate gap between a fixed-rate loan and an adjustable-rate loan reaches 3% in favor of the ARM, an ARM loan with interest rate caps and a one-year Treasury bill constant maturity index should make sense to homebuyers. Many ARMs are now written with conversion privileges, allowing the mortgagors to convert to fixed-rate loans for a modest fee during a specified period. This enables borrowers to take advantage of falling interest rates if they desire to do so. One of the standard features of an ARM is that there is no prepayment penalty.

### ***Longer Adjustment Periods Are Available***

Many borrowers prefer an ARM loan that won't adjust for periods longer than a year. For example, the low initial rate may last for three, four, or seven years, then adjust once each year. Such loans would be called 3/1, 5/1, or 7/1 ARMs. Other options would be for loans that had an initial rate that lasted five years, then went to a fixed-rate loan at the prevailing rates available for the fifth year. This would be called a 5/25. There are 3/27s, 5/25s, 7/23s, or 10/30 loans available. No one program suits everyone, so each borrower must evaluate the alternatives based on his personal situation.



**FOR EXAMPLE**

Cindy has been transferred to Lakewood and is expecting to be in that location for about three years before being transferred again. She can get a 7.5% fixed-rate mortgage with no discount points or a 5% one-year adjustable-rate mortgage with no points. The ARM has a 2% annual cap and a 6% lifetime cap. She asks for your recommendation.

What should Cindy do based on her situation?

What calculations did you use to make your recommendation?

***Disadvantages of the ARM Loan***

ARM borrowers bet against the lenders that interest rates will not rise to the extent that the maximum interest rate caps will be needed. The main disadvantages of the ARM loan are the uncertain amounts of future mortgage payments and the difficulty in calculating adjustments in interest rates as they occur. Lenders, of course, do the actual calculation of adjustments, but they have been known to make mistakes, and such mistakes can be expensive to the borrowers. Calculation details are spelled out in each loan document, but they are somewhat complicated and require the use of either a financial calculator or a handbook of ARM payment tables. For a borrower who wants to audit a lender's ARM adjustments without going to the trouble of research and math calculations, Loantech, Inc., a Gaithersburg, Maryland, mortgage consulting firm (800-888-6781), will do a complete individual ARM adjustment review for a fee, based on the terms of the loan document submitted.

**FHA Adjustable-Rate Mortgage**

Section 251 of the National Housing Act authorizes the Federal Housing Administration (FHA) to insure adjustable-rate mortgages on single-family properties. The interest rate is the sum of the index and the margin. The index changes but the margin will remain the same over the life of the loan. The initial interest rate may be a result of combining the current one-year Treasury bill index with the margin at the time the loan is closed. This combination of components produces what is often called the **calculated interest rate**. Each FHA-approved lender is allowed to discount the calculated interest rate to a lower figure if local competition requires it, or the calculated interest rate may become the initial interest rate. The initial interest rate cannot be a rate higher than the current index plus margin.

Once the initial interest rate is set, annual adjustments to FHA ARMs must be calculated. The first interest rate adjustment may not occur sooner than 12 months from the due date of the first monthly payment or later than 18 months from that first designated payment date. In other words, the first adjustment must be made during a six-month period or it is forfeited. This time frame permits lenders to complete the collection or pooling of many mortgages for sale to secondary market institutions. Whatever date is designated as the initial interest rate adjustment date, all subsequent rate adjustments must be made on the anniversary of that first adjustment date.

Unlike the conventional ARM choice of index, all FHA ARMs must use the published Constant Maturity of the One-Year Treasury Security index using the most recently available figure that applied exactly 30 calendar days before the designated change date. The new current index plus the constant margin rounded to the nearest one-eighth of 1% is the new calculated interest rate. It is then compared with the existing interest rate. If it is the same as the existing interest rate, no change is made to the existing rate. If it is up to 1% higher or lower than the existing interest rate, the new calculated interest rate becomes the new adjusted

interest rate. If it is more than 1% higher or lower than the existing interest rate, the new adjusted interest rate is limited to a 1% increase or decrease of the existing interest rate.

The new adjusted interest rate becomes effective on the designated change date and is regarded as the existing interest rate until the next allowable change date. In no event may any future combination of interest rate adjustments exceed five percentage points higher or lower than the initial interest rate.

The FHA considers interest payable on the first day of the month following the month in which the interest accrued. Therefore, adjusted monthly mortgage payments resulting from the adjusted interest rate are not due until 30 days after the designated change date. No negative amortization is allowed with FHA ARMs. The FHA requires that payments be recalculated each year to provide for complete amortization of the outstanding principal balance over the remaining term of the loan at the new adjusted interest rate. Lenders must give borrowers at least 30 days' notice of any increase or decrease in the monthly mortgage payment amount. The adjustment notice must contain the date the adjustment notice is given, the ARM change date, the new existing interest rate, the amount of the new monthly mortgage payment, the current index used, the method of calculating the adjustment, and any other information that may be required to clarify the adjustment.

### ***FHA Required Disclosure Statement***

All approved lenders making FHA adjustable-rate loans must provide each borrower with a mortgage loan information statement that includes a worst-case example form. The borrower must receive this statement and be given an opportunity to read the informative explanation before signing the borrower's certification on the loan application. Licensees are urged to obtain personal copies of the FHA adjustable-rate mortgage disclosure statement to use when counseling clients or advising customers.

### ***Advantages of the FHA ARM***

An FHA ARM has several advantages over a conventional ARM. Often, an FHA ARM bears a slightly lower interest rate because of the government insurance provided to the lender. In addition, the FHA commonly uses more lenient qualification formulas. The down payment (required investment) also is lower in many cases, and the interest rate increase each year is limited to 1%, with an overall cap of 5% (conventional caps usually are 2% per year, with a 6% overall cap). FHA loans continue to be easier to assume than conventional loans, although the FHA has increased the requirements for assumption of FHA loans. The FHA now requires a review of the creditworthiness of each person seeking to assume an FHA-insured loan.

### ***Disadvantages of an FHA ARM***

The FHA imposes a maximum loan amount that differs from region to region, depending on the cost of living in each region. Also, the FHA requires an upfront mortgage insurance premium (UFMIP) of 1.5%, although this cost may be financed along with the mortgage. If FHA loans are repaid early, mortgagors may apply for partial refunds of the mortgage insurance premiums.

## Bond Money for First-Time Homebuyers

States, counties, and cities can offer below-market mortgage financing by selling tax-free bonds. These loans are available to first-time homebuyers (who haven't owned a home for the previous three years). Sometimes divorced persons who want to buy their own home also qualify. These programs come and go, so check with local lenders for availability.

## MORTGAGE INSURANCE

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### Related websites

Fannie Mae:  
[www.fanniemae.com](http://www.fanniemae.com)

Freddie Mac:  
[www.freddiemac.com](http://www.freddiemac.com)

U.S. Department of  
Housing and Urban  
Development: FHA:  
<https://portal.hud.gov>

Federal Reserve  
Board:  
[www.federalreserve.gov](http://www.federalreserve.gov)

U.S. Department  
of Veterans Affairs:  
[www.va.gov](http://www.va.gov)

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Conventional lenders usually require that the borrower pay for **private mortgage insurance** (PMI). PMI protects the lender if the borrower defaults on the loan. The Homeowners Protection Act of 1998, which became effective in 1999, established rules for automatic termination and borrower cancellation of PMI on home mortgages. These protections apply to certain home mortgages signed on or after July 29, 1999. These protections do not apply to government-insured FHA or VA-guaranteed loans or to loans with lender-paid PMI.

For conventional home mortgages signed on or after July 29, 1999, PMI must, with certain exceptions, be terminated automatically when the borrower has achieved 22% equity in the home based on the purchase price, if the mortgage payments are current. PMI also can be canceled when the borrower requests it—with certain exceptions—when the borrower achieves 20% equity in the home based on the original property value, if the mortgage payments are current.

There are three exceptions for which the PMI may continue:

- If the loan is high-risk
- If the borrower has not been current on the payments within the year before the time for termination or cancellation
- If the borrower has other liens on the property

The FHA Homebuyer Savings Plan has also reduced mortgage insurance premiums on loans originated after January 1, 2001, to 1.5% of the original loan amount from 2.25%. FHA has also eliminated the 0.5% premium for borrowers who have achieved 22% equity in their house, based on the lower of the purchase price or the appraisal.

## SUMMARY

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Real estate licensees should assist their clients and customers in the initial two steps of prequalifying and shopping for a mortgage loan. Too often, the process begins instead with the loan application. Various proven tools and techniques exist for doing both before applying to a lender for a loan.

Fixed-rate mortgages remain popular. While the 30-year fixed-rate mortgage is the most common, 15-year and biweekly mortgages are gaining popularity. Adjustable-rate mortgages also are popular among lenders and borrowers. Conventional and FHA adjustable-rate mortgages are available. Each financing instrument has its own advantages and disadvantages, and licensees who understand the current and ever-changing mortgage market increase their chances for success in the business.



# UNIT 10

## Acquiring Financing for the Property

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › List three federal statutes that control the information a lender may obtain and consider when qualifying an applicant.
- › List the four basic loan processing procedures.
- › List two of the latest trends in mortgage lending due to computer technology.
- › Describe the difference between qualifying the borrower and qualifying the property.
- › Describe how lenders are using credit scoring to assist in the underwriting process.
- › Itemize at least three sources of income that will be counted when qualifying a buyer.
- › Explain what analyzing the title means and how it is accomplished.
- › List the components of a full title report.
- › List the two methods of obtaining assurance of good title.
- › Describe the difference between an owner's title insurance policy and a lender's title insurance policy.

### KEY TERMS

automated underwriting	Equal Credit Opportunity	paperless mortgage
automated valuation	Act (ECOA)	quality of income
computer valuation	FICO score	quantity of income
Consumer Credit	loan processing	Real Estate Settlement
Protection Act	procedures	Procedures Act (RESPA)
credit scoring	loan underwriting	title insurance

### OVERVIEW

The origination of a home mortgage is subject to a number of federal statutes, particularly the **Equal Credit Opportunity Act (ECOA)**, the **Consumer Credit Protection Act** (Title I: Truth in Lending Act), and the **Real Estate Settlement Procedures Act (RESPA)**. Together, these laws control the information a lender may obtain and consider in qualifying consumer mortgage loan applicants. They also dictate both the content and the form of information lenders must present to borrowers, the procedure for closing mortgage loan agreements, the documents to be used in closings, and the fees that may be charged.

In today's environment, lenders are required by the Civil Rights Acts, and the amendments to them, not to discriminate against consumer mortgage loan applicants on the basis of race, color, national origin, religion, sex, age, family status, or handicap. In addition, borrower rights have been better protected since the passage of the Equal Credit Opportunity Act and the Federal Reserve Board of Governors' Regulation B, which implemented the act. The act requires fair consideration of consumer loan applications from women, minorities, part-time employees, and others who may have suffered prejudicial treatment in the past.

As a result of increasing concern about protection of consumer rights, most mortgage lenders have developed specific guidelines for loan underwriters to follow to ensure compliance with federal laws affecting consumer mortgage lending. Although the guidelines are protective of consumers' rights, they do not interfere with the analysis of an applicant's credit standing. The purpose of such guidelines is to prevent homebuyers from being victimized, not to guarantee that a loan will be approved. In the final analysis, good underwriting policies and practices by a lender combine compliance with the continual search for financial safety and streamlined processing. Licensees can serve themselves and their customers well by becoming knowledgeable about residential mortgage loan processing and closing.

To accomplish the above-stated goals of government agencies and originating lenders, four basic **loan processing procedures** have been developed:

1. Determining a borrower's ability to repay the loan
2. Estimating the value of the property being pledged as collateral to guarantee the repayment
3. Researching and analyzing the marketability of the collateral's title
4. Preparing the documents necessary to close the loan transaction

Most lenders follow loan processing procedures that reflect a combined concern for the borrower's credit ability and the collateral's value. Some loan transactions require an emphasis of one factor over another, but generally, both borrower credit and collateral value are essential determinants in the real estate finance loan processing equation.

**Loan underwriting** is the evaluation of the risks involved when issuing a new mortgage. This process involves qualifying the borrower and the property to determine whether they meet the minimum requirements established by the lender, investor, or secondary market in which the loan probably will be sold.

## TRENDS IN THE MORTGAGE MARKET

The mortgage market is changing as rapidly as many other sectors of the real estate industry, and technology is the engine of that change. The last two years have seen many lenders moving their loan programs to the internet. Almost immediate loan approval is possible on the web. Credit scoring, discussed later in this unit, is changing the way mortgage interest rates are quoted. Appraisers can make restricted drive-by appraisals when a loan application is strong.

### Automated Underwriting

With **automated underwriting** a lender can enter loan application information into Fannie Mae's Desktop Underwriter software and receive a decision almost immediately. If the software determines that the buyer and the property are qualified, Fannie Mae is required to purchase the loan from the originator.

Because of the huge growth of people using the internet and the public's acceptance of the technology, lenders are moving toward **paperless mortgages**. For example, a person who applies for a mortgage online can expect to take 15 minutes to complete the application, and she will get an automated decision almost immediately. This bypasses the need for a lender to take the application. How does all this work? With **computer valuation** (automated valuation) and credit scoring.

## Automated Valuation

Some years ago, a consortium of lending organizations including Fannie Mae, Freddie Mac, Citibank, Countrywide Funding, and others, formed an organization called the National Property Data Service. The purpose was to reduce time and costs for both consumers and lenders through **automated valuation**, which uses a computer-generated valuation program.

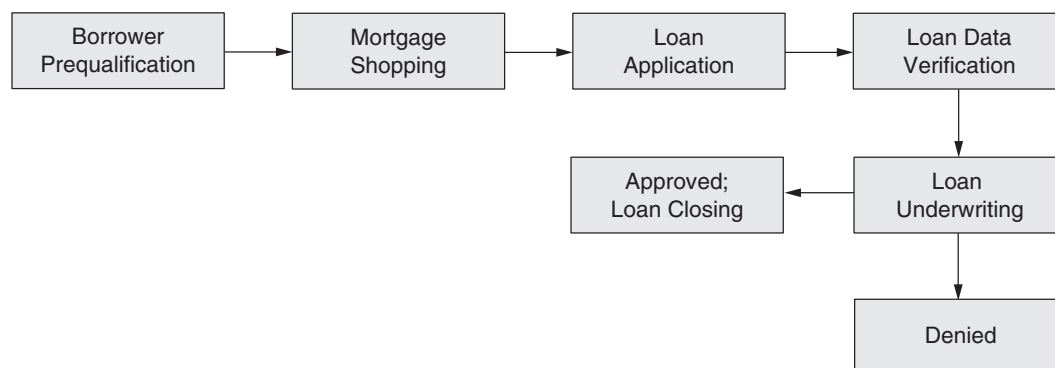
Each lender contributed all its residential appraisals to create a huge database of property descriptions and sale prices. A review of the database might show, for example, that 74% of all the homes in a given subdivision had been the subject of an appraisal over a 10-year period.

An appraiser employs matched pair analysis using two or three pairs of properties to estimate the value of a fourth bedroom, a swimming pool, or another feature. The Desktop Underwriter uses multiple linear regressions to do the same thing for that neighborhood. It uses precise dollar adjustments and, depending on the buyer's credit score, may allow an appraiser to do a streamlined property inspection (exterior only) to make an estimate of value. When Fannie Mae uses this method, it has judged the reasonableness of the sale price and has relied on the property value generated by the software.

## QUALIFYING THE BORROWER

The framework for current real estate financing is the 30-year amortization schedule and regular monthly payments of principal and interest. In addition, mortgagees currently can lend up to 100% of a property's value. High loan-to-value ratios combined with long-term loan amortization payment schedules require that a lender look to the credit of the borrower as the primary protection.

Even though lenders using insured or guaranteed programs of real estate finance do not bear the risks of default directly, they still must follow the directions of their guaranteeing agencies and carefully screen loan applicants to derive some reasonable estimate of borrowers' ability to pay and their inclinations to meet their contractual obligations responsibly. Thus, a great effort is made to thoroughly check and evaluate a potential mortgagor's credit history and current financial status to predict her future economic stability. The mortgage loan process is shown in Figure 10.1.

**Figure 10.1: Mortgage Loan Process**

## Loan Application

When a licensee works with a buyer, one of the services the licensee can offer is that of helping the buyer obtain financing. Before the buyer goes to the lender to make an application, the licensee should provide a list of items the buyer will need.

A mortgage loan application checklist is shown in Figure 10.2.



**Figure 10.2: Mortgage Loan Application Checklist**

Place personal and company information/logo here	Mortgage lender: _____ Address: _____ Loan officer: _____ Phone: _____ Date of application: _____ Time: _____
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Thanks for using our real estate firm to find your home. To assist you in making your mortgage loan application, we have prepared the list of items that may be needed by the lender. Additional information may be requested.

**The transaction:**

- ☐ Copy of the signed purchase contract
- ☐ Copy of the settlement statement (if you have sold your present home) or a copy of the signed purchase contract (if the sale is not complete)

**Your income:**

- ☐ Original pay stubs for the latest 30-day period
- ☐ Original W-2 forms for the previous two years
- ☐ If you are self-employed or have commission income: a year-to-date profit and loss statement and balance sheet; copies of your last two years' personal and business signed federal tax returns
- ☐ If you are using child support payments to qualify for mortgage: proof of receipt

**Your assets:**

- ☐ Original bank statements for all checking and savings accounts for the past three months (you should be able to explain all deposits not from payroll)
- ☐ Original statements from investment or brokerage firms for the last three months (if applicable)
- ☐ Original IRA or 401(k) statements (if applicable)
- ☐ List of real estate owned: address, market value, mortgage balance, name and address of mortgage company
- ☐ List of life insurance policies with company name, face value, beneficiaries, and cash surrender value
- ☐ List of automobiles, with make, model, value, amount owed, lender name, address and account number
- ☐ Estimate of replacement value of household furniture and appliances
- ☐ Value of other assets (collections, art, etc.)
- ☐ If you have sold a home in the past two years, a copy of the settlement statement and a copy of the deed given

**Your liabilities:**

- ☐ Credit cards: name, address, account number, monthly payment, and present balance
- ☐ Other liabilities: name, address, account number, monthly payment, and present balance

**Payments for housing:**

- ☐ List of addresses for the previous two years, along with names, addresses, and phone numbers of landlords and mortgage companies where housing payments were made
- ☐ Last 12 months' canceled checks for housing payments (landlord or mortgage company)

**If you are divorced:**

- ☐ Copies of all divorce decrees, including any modifications or stipulations
- ☐ Child support or alimony payments: amount, duration, and proof of payment for 12 months

**If you are applying for an FHA loan:**

- ☐ Photocopy of driver's license or other acceptable photo ID
- ☐ Photocopy of Social Security card

**If you are applying for a VA loan:**

- ☐ VA Certificate of Eligibility
- ☐ Form DD-214

**For in-service veterans or those discharged within the past two years**

- ☐ Statement of Service
- ☐ Most recent Leave and Earnings Statement

**Other items:**

- ☐ If you have graduated from high school or college within the previous two years, a copy of your diploma or transcripts
- ☐ If you have a gap in employment for 30 days or more, include a letter explaining the reason
- ☐ If part of your down payment is a gift, the lender will give you a gift letter for signature when you apply
- ☐ If you have filed bankruptcy in the last seven years, give a letter explaining the reasons, a copy of the Petition Decree, a Schedule of Creditors, and the Discharge document
- ☐ If you have rental property, a copy of the current lease and two year's signed income tax returns

**Your check:**

- ☐ Your check for the appraisal and application fee

## Data Verification

The loan processor will verify the information included in the application by actually checking with the various references given, the banks where deposits are held, and the applicant's employer.

## Deposits

The borrower must sign a separate deposit verification form for each bank account, authorizing the bank to reveal to the lender the current balance in the borrower's account. Under the Federal Right to Privacy Act, the bank cannot release such confidential information without a verification form. The knowledge that the loan processor can verify account amounts usually is enough incentive for the borrower to be truthful in reporting financial information. When the deposit balances are verified, the appropriate entries are made in the applicant's file.

## Employment

The applicant also must sign an employment verification form authorizing the employer to reveal confidential information concerning the applicant's job status. Not only will the applicant's wages or salary and length of employment be verified, but the employer also will be asked to offer an opinion of the applicant's job attitude and give a prognosis for continued employment and prospects for advancement. Employment may be checked again before closing.

## Credit Report

Simultaneously with the gathering of financial and employment information, the loan processor sends a formal request for the borrower's credit report to a local company offering this service. The credit report is a central part of the loan approval process and the lender relies on it heavily. Of the two types of credit reports, consumer credit and mortgage credit, the discussion here centers on the latter.

A credit report is the result of the compilation of information accumulated from a thorough check of the creditors indicated on the loan application, as well as a check of public records to discover whether any lawsuits are pending against the applicant. When completed, the credit search company sends the loan processor a confidential report of its findings.

This report usually states the applicant's (and co-applicant's) age, address, status as a tenant or owner, and length of residency at his current address and includes a brief employment history and credit profile, both past and present. The credit profile itemizes the status of current and past accounts, usually identified by industry, such as banks, department and specialty stores, and finance companies. In addition, it indicates the quality and dates of the payments made and their regularity, including any delinquency or outstanding balances. This payment history is the most important part of the report because it indicates how well the applicant has managed debt over time. Underwriters view a person's past behavior as the best indicator of future attitude toward debt repayment. Research tends to reinforce these opinions, indicating that slow and erratic payers generally retain those attitudes when securing new loans and that prompt and steady payers also are consistent in meeting their future obligations. As a result, lenders pay careful attention to the last section of a credit report, which indicates an applicant's attitude toward debt and payment pattern.

When a credit report is returned revealing a series of erratic and delinquent payments, the loan is usually denied at this point and the file is closed. If an applicant is denied a loan because of adverse information in a credit report, he has the right to inspect a summary of that report, to challenge inaccuracies, and to require corrections to be made (see the most current RESPA-required brochure, *Settlement Costs: A HUD Guide*). If one or two unusual entries stand out in a group of otherwise satisfactory transactions, the applicant will be asked to explain these deviations.

As with many standardized procedures, credit reporting has become computerized, dramatically shortening the time needed for completing a check. In exchange for time efficiency, however, credit reporting bureaus risk sacrificing the borrower's confidentiality. The fraudulent use of credit reports is increasing now that information is so easily accessible. Credit reports should be used only by the persons or institutions requesting the information and only for the purposes stated. As a result of increased seller financing, credit bureaus are receiving more requests from agents and sellers to check the credit of potential purchasers. To protect a buyer's confidentiality, most credit agencies insist on seeing the buyer's written permission before issuing any information.

After the deposit and employment verifications are returned with acceptable information and a favorable credit report is obtained, the lending officer makes a thorough credit evaluation of the data collected before continuing with the loan process.

## Evaluation of Credit Ability

Despite the standardization of the detailed guidelines used in the lending process, the one area allowing for the greatest amount of latitude in interpretation is the analysis and evaluation of a borrower's credit ability. A degree of subjective personal involvement may be introduced into an otherwise strongly objective and structured format by an evaluator's unintentional bias or by a loan company's changing policies.

In addition, credit standards are altered periodically to reflect a lender's changing monetary position. When money is scarce, standards are more stringent; when money is plentiful, standards are lowered. An applicant who qualifies for a loan at one time may not at another. Thus, although a credit analyst is governed by guidelines, rules, and regulations, the criteria fluctuate with the analyst's discretionary powers. In the long run, a lender's success is demonstrated by a low rate of default on approved loans and by the fact that no discrimination complaints have been filed.

## Credit Scoring

One of the most significant changes in mortgage lending has been the use of credit scores to better evaluate a borrower's ability to repay. Many borrowers who would have been turned down for a loan five years ago can buy today, but at higher rates.

A major reason Fannie Mae and Freddie Mac lenders are willing to make immediate loan decisions is credit scoring. **Credit scoring** uses statistical samples to predict how likely it is that a borrower will pay back a loan. To develop a model, the lender selects a large random sample of its borrowers, analyzing characteristics that relate to creditworthiness. Each of the characteristics is assigned a weight based on how strong a predictor it is. Credit scores treat each person objectively because the same standards apply to everyone. Credit scores are blind to demographic or cultural differences among people.

The most commonly used credit score today is known as a **FICO score**, named after the company that developed it, Fair Isaac Corporation. FICO scores range from 300 to 850. The lower the score, the greater the risk of default. A recent study by the Federal Reserve Board found that borrowers with low credit scores accounted for 1.5% of new mortgages, but 17% of delinquencies.

Freddie Mac has found that borrowers with credit scores above 660 are likely to repay the mortgage, and underwriters can do a basic review of the file for completeness. For applicants with scores between 620 and 660, the underwriter must do a comprehensive review. A very cautious review would be made for persons with credit scores below 620.

## Is Credit Scoring Valid?

With credit scoring, lenders can evaluate millions of applicants consistently and impartially on many different characteristics. To be statistically valid, the system must be based on a big enough sample. When properly designed, the system promotes fast, impartial decisions.

Fair Isaac has designed a system called NextGen that more precisely defines the risk of borrowers because it analyzes more criteria than the old model. Using this model, lenders can evaluate credit profiles of high-risk borrowers in terms of degrees, rather than lumping them into the same category.

## What Information Does Credit Scoring Use?

The scoring models use the following information when evaluating a score:

- Thirty-five percent of the score is determined by payment history, with higher weight for recent history. If late payments, collections, bankruptcy, or any combination of these appear in the credit report, they are subtracted from the score.
- Outstanding debt is very close in importance to payment history (30% of the total score). Many scoring models evaluate the amount of debt compared with the credit limits. If the amount owed is close to the credit limit, it affects the score negatively.
- Fifteen percent of the score is the result of credit history. A long history is better if payments are always on time.
- Ten percent of the score is based on very recent history and inquiries for new credit. If the applicant has applied for credit in many places recently, it will negatively affect the score. This problem occurs when a person goes car shopping. Broker-associates at each car lot will ask for the consumer's Social Security number in order to pull a credit report ("no charge"). The shopper has no idea that as more reports are ordered, the shopper's credit rating declines.
- Ten percent of the score is based on the mix of credit, including car loans, credit cards, and mortgages. Too many credit cards will hurt a person's credit score. In some models, loans from finance companies or title loan companies will also hurt the score.

To improve her credit score, a person should pay bills on time, pay down outstanding balances, and not take on new debt. It may take a long time to improve the score significantly.

## How Is Credit Scoring Being Used?

Residential lenders now use credit scoring the same way it is used in automobile financing and consumer loans. Interest rates on home mortgages are based on the credit score. In theory, a person with a very high score should expect to get the best rate, but typically the rate is the same for anyone with a FICO score higher than 620. Below the 620 line, several grades and interest rates have resulted.

For example, when an A+ borrower can obtain a 30-year fixed-rate mortgage at 7%, an A– borrower pays 8.4%, a B borrower pays 8.7%, a C borrower pays 9.15%, and a D borrower pays 9.95%. Before credit scoring, however, these borrowers might not have been able to get a loan at all.

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### Related websites

E-Loan (for prequalifying and credit scores):  
[www.eloan.com](http://www.eloan.com)

HSH Associates,  
Financial Publishers:  
[www.hsh.com](http://www.hsh.com)

Fair Isaac Corporation:  
[www.fico.com](http://www.fico.com)

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Many people who go to subprime lenders have only slight credit problems and end up paying 2% higher than they need to. Those borrowers may qualify for standard rates and should find out their credit scores before making a decision on a lender. If an individual cannot get his FICO score, E-Loan provides a credit score using basically the same techniques as FICO. An individual can get one free credit score by logging into ELoan and requesting the information.

The quantity and quality of an applicant's income are the two major considerations in determining her ability to support a family and make the required monthly loan payments. Analysts consider the **quantity of income**—the total income—when they review a loan application. The regular salary of a family's primary supporter is basic to the analysis, and a spouse's full income is usually accepted as well. Extra sources of income may also be included in the analysis if circumstances warrant it.

Any bonuses will be accepted as income only if they are received on a regular basis. If commissions are a large part of an applicant's income base, the history of past earnings will be scrutinized to estimate the stability of this income as a regular source for an extended time period. Overtime wages are not included in the analysis unless they have been—and will be—earned consistently. Pensions, interest, and dividends are treated as full income, although it is recognized that interest and dividends fluctuate over time and could stop if an investment is cashed out.

A second job is accepted as part of the regular monthly income if it can be established that the job has existed for approximately two years and there is good reason to believe it will continue. Child support also can be included in the determination of monthly income, but only if it is the result of a court order and has a proven track record. Government entitlement funds must also be considered.

In addition to its total quantity, a loan analyst pays careful attention to the **quality of income**. An applicant's employer will be asked for an opinion of job stability and possible advancement. Length of time on the job no longer carries the importance it once did. Applicants whose employment records show frequent shifts in job situations that result in upward mobility each time will be given full consideration. Lenders will, however, be wary of an applicant who drifts from one job classification to another and cannot seem to become established in any specific type of work.

When the accumulated data strongly supports a positive or negative decision, the loan underwriter's decision is easy and minimal use of discretion is needed. However, numerous borderline cases make it difficult for a loan officer to form objective judgments. In such a case, the loan officer schedules an in-depth personal interview with the applicant during which questions regarding data appearing on the credit report are clarified and mistakes in bank balances can be explained. More often, however, the loan officer merely wishes to visit with the applicant to observe and probe his attitudes regarding the purchase of the property

and the repayment of the prospective loan. Thus, although a person’s credit character can be measured objectively, personal character is subject to interpretation.

After reviewing all of the information provided in the application as well as the other data collected, the loan officer decides to either approve or disapprove the loan application. If the officer judges a loan application to be unacceptable, the officer states the reasons for the rejection, the parties to the loan are informed, and the file is closed.

## QUALIFYING THE COLLATERAL

Despite the current trend toward emphasizing a borrower’s financial ability as the loan-granting criterion, real estate lenders and guarantors are practical and fully understand that life is filled with events beyond one’s control. Death is a possibility that can abruptly eliminate a family’s wage earner. Economic conditions can exert devastating financial impact. Corporate downsizing and layoffs have resulted in hardship for many families. Honest mistakes in personal decisions can result in bankruptcies, often damaging or destroying credit.



### FOR EXAMPLE

You are at an open house on Sunday afternoon. A young couple asks whether they could qualify to buy the house. Based on the home’s price of \$156,000, you estimate a 90% loan would be about \$140,000. You tell them you can give them your best estimate, but that they will know for sure only after they see a lender to become preapproved. They give you the following monthly financial information:

Gross monthly income	\$4,300
Mortgage principal and interest payment at 6% for 30 years	\$839
Real estate tax escrow	\$150
Homeowners insurance escrow	\$50
Private mortgage insurance	\$45
Car payment	\$250
Credit card payments (average)	\$50

The borrower’s housing expense ratio is: \_\_\_\_\_

The borrower’s total obligations ratio is: \_\_\_\_\_

What is your informal opinion on their chances to qualify? \_\_\_\_\_

To reduce the risk of loss, real estate lenders look to the value of the collateral (the real property) as the basic underlying assurance for recovery of their investment in a default situation.

Unique financing terms or an active local housing market in which the number of potential buyers briefly exceeds the number of available properties may cause prices to rise above actual market values. Each parcel of property pledged for collateral must be inspected and appraised carefully to estimate its current market value because this amount will be used as the basis for



determining the mortgage loan amount. Depending on the type of loan to be issued and its loan-to-value ratio, either the amount determined through the formal or certified appraisal made as part of the loan process or the purchase price, whichever is less, determines the loan's amount.

Some financial institutions maintain appraisers on their staffs, but most lenders engage certified appraisers for estimates of value. All three approaches to estimating a property's value are addressed. When an appraisal is completed, it is delivered to the loan officer to aid in the final loan decision. As noted previously, a loan amount is based on the lesser of either this appraised value or the purchase price of the property.



#### FOR EXAMPLE

Which do you consider the more important factor in granting or denying a mortgage application: the borrower's ability to make the required payments or the value of the collateral? Why?

## ANALYZING THE TITLE

The assurance of good title is as essential to a loan's completion as are the borrower's credit and the collateral's value. Once the property is under contract, the listing broker will order the title commitment. The buyer's broker (representing the buyer) should make sure that the buyer's lender is included in the commitment. The lender may also require a survey or an improvement location certificate (ILC). The components of a full title report are a survey, a physical inspection of the collateral, and a search of the records to determine all the interests in a property. Normally, property interests are perfected through the appropriate filing and recording of standard notices. A recorded deed notifies the world that a grantee has the legal fee simple title to the property. A recorded construction lien, for example, is notice of another's interest in the property.

In Colorado, two methods can be used to obtain assurance of good title: (1) the abstract and opinion of title and (2) title insurance. An **abstract** is a summary of all documents affecting title to a property shown by the public records used to give an opinion of title. In most transactions title insurance is preferred. Whichever method is used, the title report should provide the loan officer and the lender's attorney with all available information relevant to the legal status of the subject property, as well as any interests revealed by constructive notice. This title search requirement represents another effort by the lender to protect the loan investment. Because title insurance is most lenders' and buyers' method of choice, it is discussed here.

### Title Insurance

Title insurance companies combine the abstracting process with a program of insurance that guarantees the validity and accuracy of the title search. A purchaser of title insurance can rely on the insurance company's assets to back up its guarantee of a property's marketable title. This guarantee is evidenced by a policy of title insurance. Most financial institutions now require that a title policy be issued to them for the face amount of a loan. Insurance is defined simply as coverage against loss. Standard practice in Colorado is for the seller to pay for the owner or buyer policy at closing. The buyer then pays for the mortgagee's policy, which protects the lender; this policy will also be paid for at closing.

When a title insurance policy is issued to a lender, it is usually in the American Land Title Association (ALTA) form. While a standard title policy insures against losses that are overlooked in the search of the recorded chain of title, an ALTA policy expands this standard coverage to include many unusual risks, such as forgeries, incompetence of parties involved

in issuing documents pertaining to the transfer of ownership, legal status of parties involved in the specific loan negotiations, surveying errors, and other possible off-record defects. Some additional risks can be and usually are covered by an extended coverage insurance policy. These include protection against any unrecorded easements or liens, rights of parties in possession of the subject property, and additional negotiated special items pertinent to the property involved. Participants in the secondary mortgage market (Fannie Mae, Freddie Mac, and Ginnie Mae) generally require the expanded ALTA policy for the added protection it provides. Many lenders use the phrase “an ALTA policy” when describing an extended coverage policy.

### Surveys or Improvement Location Certificates (ILCs)

Whether the abstract and opinion of title method or the title insurance policy method is used, a property's title is searched by an experienced abstractor, who prepares a report of those recorded documents that clearly affect the quality of ownership. In addition, lenders sometimes require a survey or an ILC for the collateral property as a condition for a new loan. Although many properties are part of subdivisions that have been engineered and described by licensed and registered surveyors and engineers, some owners might have enlarged their homes or made additions to the improvements since the original survey. These might not meet the various setback restrictions set forth in local zoning laws. Some properties might have been resubdivided, while others might have encroachment issues. A survey will identify the property boundaries and all improvements, while an ILC will simply locate the improvements relative to the property line. Both will note any encroachments. Typically for an urban property a survey or an ILC is not required. The broker-associate should check with the lender and title company to see if they are going to require a survey or an ILC before ordering them, since this can save the buyer or seller anywhere from \$150 to \$2,000 at closing if one is not required.

### Defects

If a defect, sometimes called a *cloud on the title*, is found, the loan process does not continue until the cloud is cleared to the buyer's and lender's satisfaction. Such a cloud could be an unsatisfied construction lien, an income tax lien, a property tax lien, an easement infraction, an encroachment, or a zoning violation. Sometimes a borrower's name is not correct on the deed, an error exists in the legal description, or the deed has a faulty acknowledgment or lacks the appropriate signature(s). Because of the many complexities in a real estate transaction, there are possibilities for defects to appear in a title search and property survey. It is the abstractor's responsibility to discover and report them.

In certain instances where clouds are difficult to remove by ordinary means, they must be cleared by filing suit to quiet title. After appropriate evidence is submitted, a judge removes or modifies an otherwise damaging defect in a title. The loan process can continue when a clear chain of title is shown on the public records.

## SUMMARY

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The process of obtaining a real estate loan includes four steps: qualifying a borrower, evaluating the collateral, analyzing the title, and closing the loan transaction.

Beginning with an application to obtain a loan, the borrower's credit, financial condition, and personal attitudes are analyzed to determine his ability and willingness to honor debts



and repay the loan as agreed. Current assets and employment are verified, a credit rating is obtained, and often a private interview is held between the borrower and loan officer to estimate certain credit characteristics. Other basic criteria used to determine the applicant's creditworthiness include gross monthly earnings of approximately four times the required monthly mortgage payment (sometimes higher for large loans), stability of earnings, and a good prognosis for continued employment and advancement.

Once the loan applicant's credit is accepted, either a staff appraiser or an independent fee appraiser analyzes the value of the real estate to be pledged as collateral. A certified appraisal report offering the appraiser's opinion of the subject property's value is submitted to the loan officer.

After the borrower's credit and the collateral's value are verified, the legal status of the property's title is examined and analyzed carefully, usually by a trained abstractor. The title commitment or title report is delivered to the lender's attorney for an opinion of accuracy and validity. Because of the growing activity of this nation's secondary mortgage market and its concurrent necessity for added protection, lenders generally require title insurance to guarantee the title search.

Finally, after approval of the borrower's credit, the collateral's value, and the title's marketability, the loan processor prepares the documents necessary for closing. With the delivery of the funds to the seller and the recording of the necessary papers transferring title, the loan transaction is completed.



# UNIT 11

## Closing Real Estate Transactions

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Name the steps that a broker-associate must follow after writing a contract to ensure a timely closing.
- › List the tasks that a broker associate should complete after a closing.
- › Describe the reasons why a licensee might not want to personally order repairs on a property and what steps can be taken to protect the broker-associate from liability.
- › List at least four objectives of a preclosing inspection.
- › Describe the reasons a real estate broker-associate should provide closing documents to the buyer and seller at least one day in advance of a closing.
- › List the proration items paid in advance and those paid in arrears.
- › Prorate rent, interest, and property taxes.
- › Describe the methods lenders use to set up an escrow account for prepaid taxes, hazard insurance, and private mortgage insurance.
- › Calculate prepaid interest for a new loan.
- › Calculate the expenses on the settlement statement.
- › Prepare and review a settlement statement.

### KEY TERMS

certified check

mortgage insurance  
premium (MIP)

preclosing walk-through  
inspection

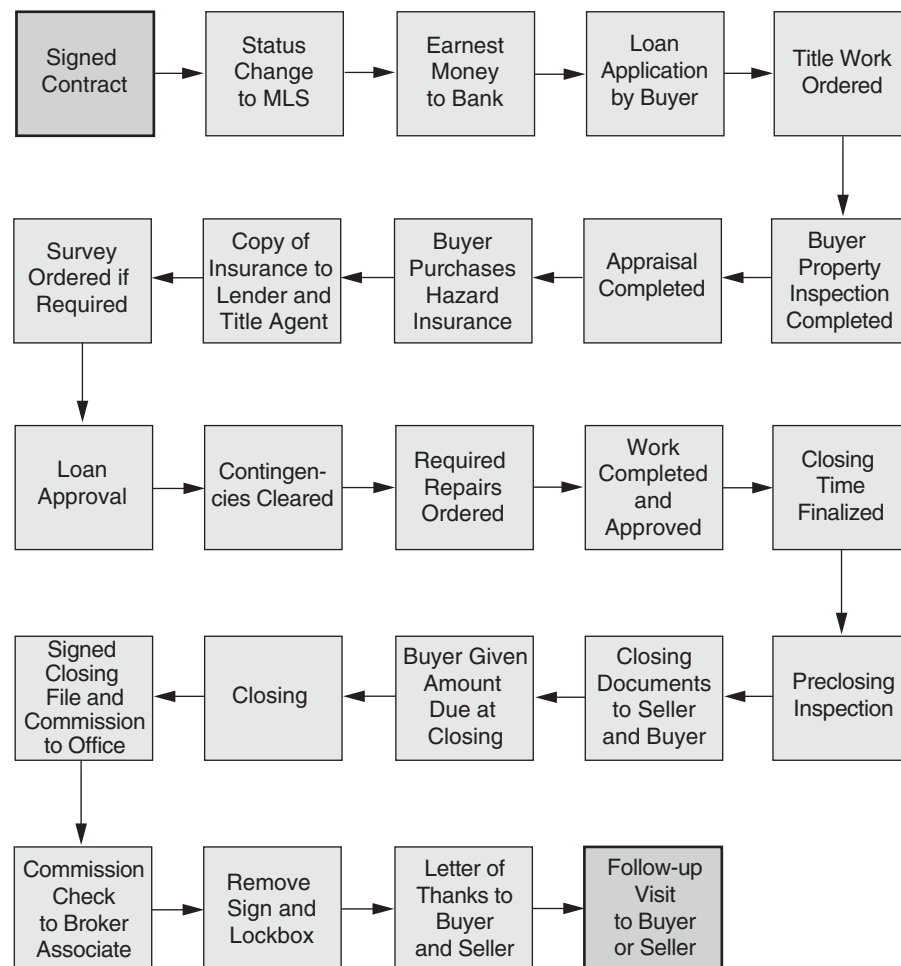
### OVERVIEW

Closing the transaction is the final and most important step in the transaction. The listing brokerage firm and the designated listing broker are responsible for the overall closing. In addition, the designated buyer's broker will be responsible for the buyer's settlement statements. Brokerage firms and employing brokers are responsible for training their broker-associates on the closing process and must be available for new agents by either attending the closing or being available to answer questions. Upon completing this unit, broker-associates should be familiar with the closing process and closing documents and be ready for that special day when they have their first closing.

## THE CLOSING PROCESS

Once the real estate contract has been signed, the licensee's work has just begun. The parties to a transaction expect their broker-associate to personally monitor and coordinate all the details of their closing. While the licensee may believe he has “passed the torch” to the next group of professionals (lenders and closing agents), the buyer and seller continue to look to their broker-associate to coordinate all the details of the transaction. A smooth transition from contract to closing enhances the reputations of the firm and the sales associate. This section is intended to help licensees better understand the process and to follow the “road to closing” successfully (see Figure 11.1).

**Figure 11.1: The Road to Closing**



Some important steps a licensee may take to reduce problems with title closing include the following:

- Disclose everything to all parties that will affect their decisions before the buyer and seller sign the contract—surprises after a contract is signed almost certainly will result in one party wanting to get out of the contract.
- Write the contract carefully and properly explain it to the parties.
- Recommend that buyers and sellers select lenders and title closing agents who are organized professionals able to meet deadlines.
- Tell the loan officer and closing agent what the licensee expects in the way of communication and performance.

- Prepare a Property Sale Information Sheet from your company or use the one in Figure 11.2.
- Give the closing agent a copy of the prior title insurance policy, if possible.
- Provide a complete legal description of the property to the closing agent.
- Ask the lender and title agent to communicate by email, speeding the process while also giving written documentation of the transaction.
- Use a checklist of duties, such as the closing progress chart provided in Figure 11.3.

**Figure 11.2: Property Sale Information Sheet**

Property address: _____	
Seller: _____ Buyer: _____	
Contract date: _____ Closing date (est.): _____	
Seller	Buyer
<b>Listing broker:</b> _____ Phone: _____ Fax: _____ Listing broker-associate: _____ Home phone: _____ Office phone: _____ Mobile phone: _____	<b>Buyer's broker:</b> _____ Phone: _____ Fax: _____ Buyer's broker-associate: _____ Home phone: _____ Office phone: _____ Mobile phone: _____
<b>Seller:</b> _____ Old address: _____ New address: _____ City, state, ZIP: _____ Current home phone: _____ Office: _____	<b>Buyer:</b> _____ Present address: _____ City, state, ZIP: _____ Current home phone: _____ Office: _____ Will buyer occupy new home? _____
Existing mortgage for payoff (P) Assumption (A) 1st mortgage holder: _____ 2nd mortgage holder: _____	New mortgage lender: _____ Type (fixed; ARM: FHA, VA, conv.): _____ LTV ratio: ____%    Interest rate: ____%    Yrs: ____
Seller's attorney: _____ Phone: _____	Buyer's attorney: _____ Phone: _____
<b>Lender:</b> _____ <b>Title company:</b> _____ <b>Appraiser:</b> _____ <b>Date scheduled to close:</b> _____ <b>Service providers:</b> Pest inspection: _____ Home inspection: _____ Roof inspection: _____ Contractor: _____ Surveyor: _____	<b>Loan officer:</b> _____ <b>Closing agent:</b> _____  Phone: _____ Phone: _____ Phone: _____ Phone: _____ Phone: _____
<b>Buyer's insurance company:</b> _____ Agent: _____ Phone: _____ Property status: <input type="checkbox"/> Occupied by seller <input type="checkbox"/> Occupied by tenant <input type="checkbox"/> Vacant <b>Key to property for inspection:</b> <input type="checkbox"/> At listing office <input type="checkbox"/> In lockbox at property <input type="checkbox"/> Call seller for appointment	

**Figure 11.3: Closing Progress Chart**

Listing Broker-Associate								
#	Sched. Date	Actual Date	X	Closing Duties	Done	X	Sched. Date	Actual Date
1				Sale Pending sign on listing				
2				Notice of under contract to MLS				
3				Binder deposited in bank: \$ _____				
4				Additional binder received, if required: \$ _____				
5				Loan application made by buyer				
6				Contingencies cleared in writing:				
7				Home inspection by: _____				
8				Soil test from: _____				
9				Roof inspection by: _____				
10				Other (describe): _____				
11				Appraisal by: _____				
12				Loan approval from: _____				
13				Title insurance ordered from: _____				
14				Report received and delivered to buyer				
15				Report received and delivered to lender				
16				Treatment ordered, if required				
17				Structure inspection ordered, if necessary				
18				Work completed and approved				
19				Required repairs ordered				
20				Required repairs completed				
21				Survey ordered (after loan approval)				
22				Survey completed. Results..				
23				Encroachments, survey problems cleared				
24				Buyer to get hazard insurance				
25				Insurance policy to title closing agent				
26				Buyer/seller contacted for closing appointment				
27				Preclosing inspection				
28				Closing papers reviewed with buyer/seller one day prior				
29				Buyer given figure for certified check for closing				
30				Binder check prepared to take to closing				
31				Closing date				
32				Signed closing papers received by broker-associate				
33				Postclosing duties:				
34				Commission check to broker				
35				Sign/lockbox picked up from property				
36				Buyer/seller letter of thanks				
37				Follow-up visit to buyer/seller				
38				Notice of closed sale to MLS				

A broker-associate must be familiar with the documents that will be presented to the parties at the closing table. One of the most important documents, the Closing Disclosure, relates to the financial side of the transaction. A settlement statement is, in effect, the purchase and sales agreement reduced to numbers. The broker-associate must understand each number in the statement and be able to explain it clearly to the buyer or seller.

## **The Sales Information Sheet**

To organize the work program, the broker-associate needs to complete the Property Sale Information Sheet. The brokerage firm or a contract computer software program may have this form. It provides necessary data about the sale, the cooperating agent, the lender, the title company, and more. This form should be clipped inside the closing file and referred to as necessary when servicing the sale.

## **Establishing a Plan of Action**

One of the first steps after both the buyer and the seller sign the contract is to set up a plan for closing. This step is even more important if another broker-associate is involved because miscommunication often delays closings and causes unnecessary problems. Organization and attention to detail are key to a successful closing.

## **The Closing Progress Chart**

The closing progress chart will help the licensee organize the details of the closing. If there is a cooperating licensee, the chart should be a joint effort so that licensees agree about which licensee will handle certain duties and when the tasks should be completed. Once agreement has been reached, each broker-associate should place a copy of the chart in the closing file. Additionally, each date scheduled should be transferred to the broker-associate's appointment book. As each task is completed, the broker-associate should place a check mark in the appropriate row. An "X" in the chart indicates that comments have been made on the back of the form. A discussion of each item follows.

## **Preclosing Duties**

### ***Sold or Sale Pending Sign on the Listing***

Placing a Sold or Sale Pending sign on the listed property is a function of the listing sales associate. Some sellers prefer a Sold sign so that prospective buyers are no longer escorted through the property, while others do not want to discourage activity until at least after the buyer's loan approval.

### ***Notice of Under Contract to the MLS***

Most multiple listing services require that all offices be notified of a listed property's status change within one business day after the change occurs. Failure to change the status to under contract or to taking backups can result in agents from other offices wasting time trying to set showings and is against MLS rules and regulations.

### ***Earnest Money Deposited in the Bank***

The listing broker-associate should give the earnest money deposit to the employing broker as soon as the offer has become a contract. If the buyer's broker faxed a copy of the earnest money check when submitting the offer, the broker should be sure to get the earnest money check to the listing broker immediately upon acceptance. Colorado Real Estate Commission rules require that the buyer's earnest money deposit be placed in a bank no later than three business days after acceptance of the offer. If a title closing agent will hold the deposit, the broker must deliver the deposit to the title closing agent within the same time frame allowed by the Commission for depositing the funds in a brokerage account. The broker should get a closing instructions earnest money receipt form signed when delivering the funds to the title company.

### ***Earnest Money Promissory Note***

If the buyer has given a promissory note, the listing broker is responsible for collecting the funds before closing and by the date listed in the promissory note. If the listing broker cannot collect the money from the buyer, notification must be sent to the seller.

**Remember:** The promissory note does not establish any specific amount the buyer will be charged in interest should the seller be required to collect the promised deposit from a delinquent buyer. When making the note, the buyer agrees to all reasonable fees, with no set limit.

If the contract requires that the buyer put up additional earnest money as a good-faith deposit, it is the broker-associate's responsibility to ensure that the funds are received and deposited on a timely basis. The buyer's failure to comply with contract requirements is a default. The seller must be notified and the seller's instructions followed.

### ***Loan Application Made by the Buyer***

The Contract to Buy and Sell requires that the buyer apply for the loan by a certain date. The buyer's failure to comply with contract terms is a default. The seller must be notified, and the buyer may lose his earnest money.

### ***Contingencies Cleared in Writing***

The broker-associate must ensure that contingencies are satisfied as soon as possible. Some normal contingencies include a home inspection, a soil test, a roof inspection, and financing. If a problem arises with one of the contingencies, the broker-associate should do everything possible to correct the problem and all parties should be made aware of the situation. If more time is needed, the brokers should extend the deadlines for the contingencies, with the agreement of the seller and buyer, using the amend/extend contract form.

### ***Appraisal***

The appraisal normally is ordered and paid for at the time of loan application. The broker-associate wants to be certain that the appraiser selected by the financial institution has complete cooperation, particularly with respect to access to the property. Failure to provide access wastes the appraiser's time and may delay the closing.



### ***Loan Approval***

The Contract to Buy and Sell requires a loan commitment within a certain number of days from the contract's effective date. The licensee must monitor the lender's progress and provide to the lender without delay any information or documents requested. The lender's failure to provide the commitment within the required time may put the buyer's earnest money in jeopardy.

### ***Title Insurance Ordered***

Typically, the listing broker will order the title insurance after discussing which company to use with the seller. Once the offer has been accepted, the buyer's broker should immediately deliver the contract, earnest money, and financing information to the listing broker if she has not already done so. The listing broker should ask for a title request and closing sheet from the title company and then use the form to give the title company and closing entity all the necessary information requested. Typically, the following items will be requested when a title insurance order is placed:

- A signed and dated sales contract with all attachments
- A previous title insurance policy on the property, if available
- Enough information about the sellers, buyers, property, and lender to process and close the transaction, including the following:
  - The sellers' and buyers' full names, contact information and addresses, if not specified in the contract
  - A complete legal description—for example, lot, block, subdivision name, phase or unit, recording information, and county
  - Street address, including ZIP code
  - Terms of any legal documents the title company must prepare

**Remember:** The title company acts as a scrivener to fill out these documents. The listing broker hires the title company to complete these documents using the closing instructions and earnest money receipt form. This must be completed by the title deadline.

- Closing date and information about whether all parties will attend
- Information on the commission to the broker and commission splits between brokers

### ***Inspection Ordered***

The inspection should be ordered as soon as possible after contract acceptance. The inspection must be completed on or before the inspection objection deadline. If the buyer has any requests for repairs or if he wishes to terminate the contract, the buyer's broker-associate must give a completed and signed inspection notice with the buyer's request to the listing broker-associate before the inspection objection deadline. If the buyer has requested repairs, the buyer and seller will then have until the inspection resolution deadline to negotiate what will be done and how. For example, the seller may choose to offer monetary compensation at closing in lieu of doing the actual work. The buyer and seller are also agreeing on the date that the repairs will be completed by (typically, a few days or the week before the closing). The parties must resolve what is to happen with all the inspection issues by the resolution deadline, but if the buyer and seller cannot come to an agreement, the contract will terminate 24 hours

after the resolution deadline and the buyer's earnest money will be returned, unless the buyer removes his request for repairs.

### **Required Repairs**

Once the inspection notice has been completed and any requested repairs agreed to, the listing broker should work with the seller to make sure the repairs are completed by the walk-through date listed. If the repairs are not complete, the brokers will need to extend the contract using the amend/extend contract form.

### **A Note of Caution to Licensees**

A licensee sometimes orders major repair items without the seller's authorization to do so. A failed closing can have adverse financial consequences for the broker-associate aside from the loss of commission. While a broker-associate might facilitate some of the legwork required in getting estimates, the broker should not order the work without written approval. The seller or buyer, as appropriate, should contract for the work. This also makes the contractor responsible to the appropriate party if any warranty work is necessary later.

A sample form, the authorization for broker-associate to order work, can be found in Figure 11.4.

**Figure 11.4: Authorization for Broker-Associate to Order Work and Customer's Agreement to Pay**

Re: property address: \_\_\_\_\_

Responsible person: \_\_\_\_\_ as ☐ Owner ☐ Buyer

Address: \_\_\_\_\_

Phone number: \_\_\_\_\_

I hereby authorize \_\_\_\_\_ of \_\_\_\_\_

to order on my behalf the item specified below and agree to pay for said item upon demand as required by the supplier regardless of the outcome of this property transaction. I understand that these arrangements are being made by the broker-associate as a courtesy to me. I shall look to the supplier only for performance and workmanship and absolve the broker-associate and brokerage firm for the performance and workmanship of the supplier.

Item to be ordered by broker-associate:

\_\_\_\_\_

\_\_\_\_\_

Supplier: \_\_\_\_\_ Price quoted: \_\_\_\_\_

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

**Figure 11.4: Authorization for Broker-Associate to Order Work and Customer's Agreement to Pay (continued)****Supplier Agreement to Provide Service and  
to Look Only to Responsible Party for Payment**

Re: property address: \_\_\_\_\_

City: \_\_\_\_\_

Supplier: \_\_\_\_\_

Phone number: \_\_\_\_\_

I agree to provide the item/service specified below and agree to seek compensation from the "responsible party" shown above. I understand that these arrangements are being made by the broker-associate in this transaction as a courtesy to me. I agree to look to the "responsible party" only for compensation and absolve the broker-associate and brokerage firm for the cost of the item/service.

Item to be ordered by broker-associate:

\_\_\_\_\_  
\_\_\_\_\_

Supplier: \_\_\_\_\_ Price quoted: \_\_\_\_\_

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

***Required Repairs Completed and Approved***

When the work has been completed, the appropriate party should inspect the work on the date listed in the agreement to be sure that it has been done properly. A licensee who takes on this responsibility may be held responsible if deficiencies are discovered later.

***Survey Ordered***

Before writing the offer, the broker should verify whether the title company or lender will require a survey or an ILC. If neither the title company nor the lender require one and the buyer does not want one, this expense can be removed by not ordering these items. If the lender or the title company does request a survey, the survey should be conducted after the loan commitment deadline date.

A licensee who orders the survey without written approval may be liable for the fee if the sale does not close. In the case of survey problems such as encroachments, the broker-associate must act quickly to help clear up the problems.

***Buyer Purchases Hazard Insurance***

The buyer should purchase a hazard insurance policy as soon as possible in the transaction and certainly must know by the property insurance objection deadline whether she is going to be able to obtain coverage on the property. In years with wildfires in the mountain areas of Colorado, some buyers have found that they cannot get insurance at an affordable rate and have had to terminate the contract.

### ***Preclosing Inspection***

The buyer should make a **preclosing walk-through inspection** on the date detailed in the contract. The inspection is to ensure that

- the property is ready for occupancy;
- personal property the seller is required to leave remains on the property;
- all required repairs and maintenance have been completed; and
- the property has been maintained in the condition as it existed at the time of contract, ordinary wear and tear excepted.

The broker-associate should not conduct such an inspection because of the liability involved. When the inspection has been completed to the buyer's satisfaction, the broker-associate should ask the buyer to sign a preclosing walk-through inspection results form.

An example of a preclosing walk-through inspection results form can be found in Figure 11.5.

**Figure 11.5: Preclosing Walk-Through Inspection Results**

Property address: \_\_\_\_\_ Date of inspection: \_\_\_\_\_

Seller: \_\_\_\_\_ Buyer: \_\_\_\_\_

I have made a walk-through inspection of the property. I acknowledge that the broker-associate has accompanied me to the property to make it available, and not to conduct the inspection. I take complete responsibility for the inspection and agree to hold harmless the broker-associate and the brokerage firm from any liability in connection with the inspection.

My inspection shows that:

1. Personal property items required by the contract to be left are present in the property ☐ Yes ☐ No
2. Required repairs, if any, have been completed ☐ Yes ☐ No
3. The property has been maintained in the condition as it existed at the time of the contract, reasonable wear and tear excepted ☐ Yes ☐ No

Comments \_\_\_\_\_

I accept the property as inspected and release the sellers, broker-associates, and brokers in this transaction of any further responsibility for the property. I have been notified of the benefits of having the property covered by a homeowner's warranty. If the seller has not provided such a warranty, I ☐ accept ☐ decline to purchase coverage at a cost of \$ \_\_\_\_\_.

Buyer: \_\_\_\_\_ Date: \_\_\_\_\_

Buyer: \_\_\_\_\_ Date: \_\_\_\_\_

### ***Closing Documents Reviewed With the Buyer and Seller One Day Before Closing***

A broker-associate should attempt to work with lenders and title closing agents who understand the broker-associate's need to provide the highest level of service to the customers. Those lenders and title agents work diligently to provide all documents for the closing one day in advance. The broker-associate must monitor all phases of the closing, including a careful review of the settlement statements. Many buyers and sellers attend their closings—at which large sums of money are disbursed—without having seen any of the documents beforehand. They are expected to sign all documents after a cursory review at the closing table. This is not

fair to the participants and can lead to embarrassment for their broker-associates. Often a broker-associate gets little more than the dollar amount that the buyer must bring in the form of a cashier's or **certified check**. This is simply not satisfactory to the broker-associate who wishes to handle the closing professionally.

Upon receiving the documents, the broker-associate should make an appointment to visit the buyer or seller and deliver copies of all documents that the person will sign. The broker-associate should review the settlement statement carefully to ensure that all items are correct and should explain each item to the buyer or seller at the appointment. The broker-associate working with the buyer should compare the settlement statement with the lender's good-faith estimate. The broker-associate working with the seller should compare the figures to those given to the seller on the approximate seller's net proceeds form. The closing will go more quickly and pleasantly for the person who has reviewed all documents the evening before.

Settlement statements are covered later in this unit.

### ***Buyer Given Figure for the Certified Check for Closing***

This figure should be provided to the buyer as soon as possible to allow for time to get a certified check for the proper amount from his bank. The check should be made payable to the buyer. At closing it will be signed over to the closing company, but making the check out to the buyer will make it easier for the buyer to keep his money if for some reason the transaction fails to close.

### ***Earnest Money Check Prepared to Take to Closing***

If the listing brokerage firm has the earnest money in their trust account, at least one day before the closing the listing broker-associate should arrange to get a good funds earnest money check from her employing broker and clip it to the file folder that will be taken to the closing. Good funds are required at closing. Any bank-certified check is considered good funds. Personal checks are not considered good funds. Also included in the folder will be the contract and other related materials for this closing. If the earnest money was already given to the title company and not deposited in the brokerage firm's trust account, the listing broker will not need to bring the money to closing.

## **THE SETTLEMENT STATEMENT**

Buyers and sellers expect their broker-associates to coordinate and monitor every step of the closing process. The last step is the closing itself. A broker-associate must be familiar with the documents that will be presented to the parties at the closing table.

A settlement statement is, in effect, the purchase and sales agreement reduced to numbers. The broker-associate must understand each number in the statement and be able to explain it clearly to the buyer or seller. Understanding the settlement statement will make the process easier.

## **PRORATIONS AND PREPAYMENTS**

In every closing, property income and expenses should be prorated between the buyer and the seller. In Colorado, the 365-day method is used for prorations of annual expenses. The annual cost is divided by 365 days to get a daily rate. That rate is then multiplied by the number of days involved to get the amount due. When calculating prorations using the 30-day month method (as on the national portion of the Colorado real estate licensing exam), the annual

cost is divided by 360 days; that rate is then multiplied by the number of days involved to get the amount due.

Proration calculations should be based on the last day of seller ownership. The day of closing is charged to the buyer in Colorado (and to the seller for the national portion of the exam).

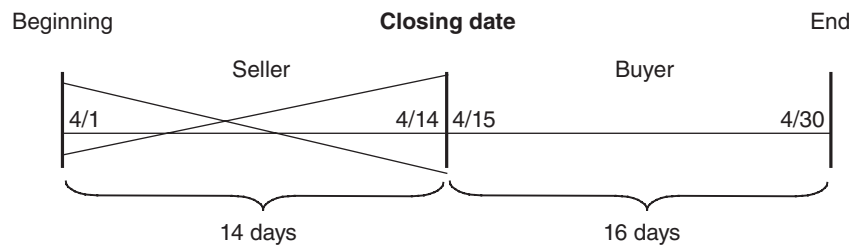
The most common items prorated on a closing statement are rents, property taxes, and interest on assumed mortgages. While insurance can be prorated between the parties, this is not recommended and usually is not allowed by the insurer. The buyer should purchase a new policy and the seller should cancel the existing policy. The full amount of the security deposits, which belong to the tenant, will be transferred from the seller to the buyer at closing.

## Prorating Rent

If the property is an income property, the seller should pay the buyer any rent that applies for the period after closing. The first step is to see the problem graphically by drawing a timeline. The rental period is shown, as is the day of closing. The following example illustrates the various aspects of proration and prepayments. In the example, if the seller had collected the rent in advance, the seller would owe the buyer 16 days of the rent.

Closing date: April 15

Rent collected for April: \$450



Since the rent was paid by the tenant for the month, the seller will owe the buyer for the 16 days the buyer is the new owner. Draw an X through the side that does not apply as a reminder of which side to work the proration.

Daily rate:  $\$450 \div 30 \text{ days} = \$15$

Proration:  $\$15 \times 16 \text{ days} = \$240$

Debit the seller \$240 and credit the buyer \$240.



### FOR EXAMPLE

Calculate the following rent proration:

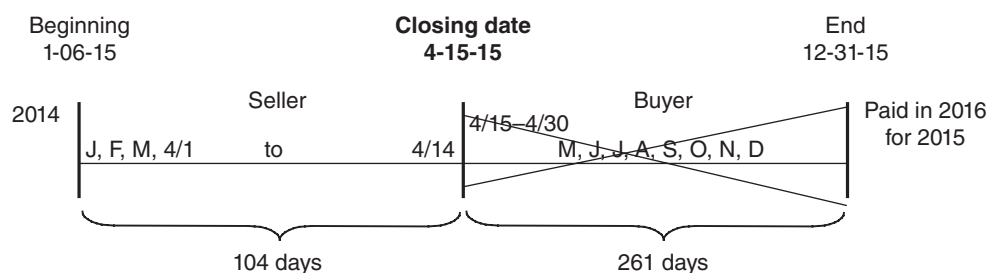
Closing Date	Rent Received	Debit	Credit	Amount
July 12	\$760			\$
November 12	\$900			\$
January 6	\$425			\$

## Prorating Property Taxes

In Colorado, property taxes are paid in arrears so they will be a debit to the seller and a credit to the buyer. If the seller has not paid the taxes for the previous year, the seller alone owes the entire amount due from the previous year (unpaid taxes from prior years are not prorated between buyer and seller—these are debts the seller owes and must pay). Typically, the tax amount from last year will be used to prorate the amount of this year's tax unless there has been a more recent mill levy and the Contract to Buy and Sell calls for the newer levy amount to be used.

Closing date: April 15

Property taxes: \$2,275



Since the taxes are paid in arrears and the seller owes the buyer, draw an X through the side that does not apply as a reminder of which side to work.

Number of days from January 1 through April 15:

January	31
February	28
March	31
April	14
Total	104

Daily rate:  $\$2,275 \div 365 \text{ days} = \$6.23288 \text{ per day}$

Proration:  $\$6.23288 \times 104 \text{ days} = \$648.22$

Debit the seller \$648.22 and credit the buyer \$648.22.



### FOR EXAMPLE

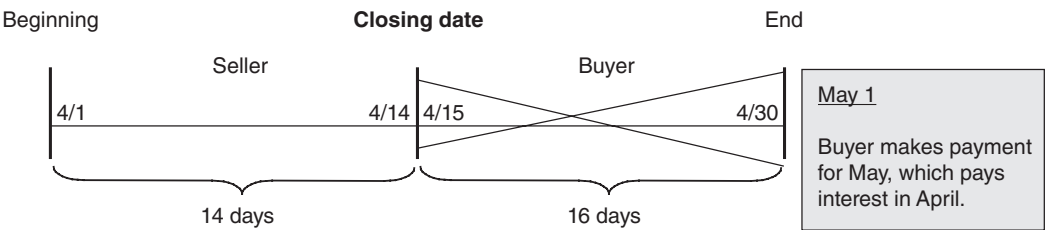
Calculate the following property tax prorations:

Closing Date	Taxes	Debit	Credit	Amount
September 12	\$2,567.00		\$	
November 18	\$4,260.00		\$	
April 24	\$1,892.56		\$	

**Prorating Interest**

Interest is prorated between the parties when a loan is to be assumed. Interest is paid in arrears. For example, when the mortgage payment is made on May 1, it pays the principal due on May 1 and the interest for the month of April.

Closing date: April 15  
Mortgage balance on April 1: \$67,125  
Interest rate: 8%  
Interest for April: \$447.50 ( $\$67,125 \times 0.08 \div 12$  months)  
Daily rate:  $\$447.50 \div 30$  days = \$14.91667 per day  
Proration:  $\$14.91667 \times 14$  days = \$208.83  
Debit the seller \$208.83 and credit the buyer \$208.83.



**FOR EXAMPLE**

Calculate the following interest prorations for these assumed mortgages:

Closing	Mortgage Balance	Interest Rate	Debit	Credit	Amount
October 12	\$137,500.00	9.0%			\$
November 18	\$246,532.50	8.5%			\$
April 24	\$91,892.56	10.0%			\$

**AT THE CLOSING TABLE**

The closing normally includes the buyers, the sellers, and their respective licensees, if any. Sometimes attorneys of the parties attend, and occasionally a lender’s representative will attend as well. The title company closer conducts the closing, starting with closing the real estate side where the deed is transferred. The closer typically goes over the seller’s settlement statement with the seller first. The settlement statement and all the seller’s documents are signed by the seller and, when required, by the listing broker. The closer will close the buyer’s side next. This entails not only the real estate documents but often also the loan documents. The buyer and, when required, the buyer’s broker will sign all the documents. Once the paperwork is completed, the closer will then deliver or collect checks from the appropriate parties.



## Closing Disputes

The title closer is not an advocate for any of the parties. It is the title closer's job to close the transaction based on the contract and the lender's closing instructions. The designated broker for each party should be at the closing and be prepared to solve any problems that might arise. Each broker is responsible for her party's settlement statement being correct. If there is a problem between the buyer and the lender, the broker gets them together on the phone. If there is a dispute between the buyer and the seller, the brokers should work to help the parties settle the dispute.

## The General Warranty Deed

The general warranty deed is the most common deed for residential property, with the seller guaranteeing to the buyer a good title, without material defects or encumbrances, and that he will stand by the guarantee forever. Special attention should be given to the names and legal description and to any items in the subject to section, such as restrictive covenants and unsatisfied mortgages.

## Loan Application

Usually, the lender will want a typed loan application signed at closing, verifying the information given to the lender at the time of application.

## Note

The closer presents the note for the buyer's signature. The note shows the principal balance, the number of payments, and the dates and the amount of the payments. The amount will be for the principal and interest only. The first payment date will normally be the first day of the second month after closing. The note is not witnessed or notarized. If a signature appears on the face of the note along with the borrower's signature, that person becomes a cosigner on the note.

## Deed of Trust

The deed of trust is the security for the note. It is the document that may require that the borrower pay one-twelfth of the ad valorem taxes and the hazard insurance and **mortgage insurance premiums**, along with the principal and interest. It requires that payments be made on time, that taxes be paid, and that the property be covered by insurance, and it describes prepayment options. It also usually states that a sale or an alienation of the property will make the loan due immediately.

## Other Documents

Some of the other documents the buyer may sign include an anticoercion statement that says the lender did not require that the buyer choose a certain insurance company. The lender and title insurance company will want a compliance agreement that the parties will do anything necessary to give the lender an acceptable loan package, such as signing new documents, if required. If the loan is above 80% of a home's value, the lender will want an affidavit that the buyer will occupy the property. The seller will be required to sign an affidavit that (1) the seller owns the property, (2) the seller has the right to convey it, and (3) it is not encumbered by any lien or right to a lien, such as a construction lien. If there is a new loan the buyer may be asked to waive homestead rights so the deed of trust lien can be in first position.

## **Disbursements at Closing**

Everyone expects to be paid at closing. This is not always possible, and licensees should be prepared to explain the problem to the sellers. Perhaps an example using a broker's trust account is easier to understand. Many real estate brokers have hundreds of thousands of dollars in their escrow accounts. A broker who disburses from the escrow account before making a deposit into the account, even if the future deposit would be in certified funds, is guilty of a serious violation because he would be using funds that belong to others.

Title insurance companies are faced with a similar problem. Some title insurance companies agree to disburse the proceeds at closing if the certified checks will be deposited by the close of business that day. (A real estate broker may never do this.) Many title insurance companies will not disburse if the closing takes place too late to make a same-day deposit or if the lender is holding the loan proceeds check until the loan package is delivered.

## **Signed Closing Papers Received by the Sales Associate**

The broker-associate should be careful that the office file is fully documented. This includes any walk-through clearance papers the buyer signs for the seller and the settlement statements all parties must sign. If disbursement is made at closing, the commission check also is received at this time. Typically, the broker-associate will have a closing control sheet given to her by her office. The broker-associate should go through her file before the closing and note any documents she will need to obtain at closing on the control sheet. It is very difficult to get required signatures from the buyer and seller after closing, so the licensee must be sure she has all her required documents properly signed before leaving the closing.

## **Postclosing Duties**

### ***Commission Check Given to the Broker***

Upon returning to the office, the broker-associate should give the closing file and the commission check to the broker. Often, closing documents are uploaded to the firm's file system digitally. The licensee receives a check for their portion of the commission at the closing and the broker's check is mailed to the broker, saving the licensee time.

### ***Sign and Lockbox Picked Up From the Property***

The listing broker-associate should ensure that the sign and lockbox are removed from the property and returned to the office. Often the associate does this just before closing. Many broker-associates remove the lockbox for security reasons immediately after the contract has been signed.

### ***Letter of Thanks to the Buyer or Seller and the Broker***

The letter, which should include both the broker-associate's and the employing broker's signatures, will be appreciated by the customer, will foster goodwill, and will likely result in future business. Many companies request that the buyer or seller complete a questionnaire about the level of service provided in the transaction. A thank-you note to the other broker will also foster goodwill and help establish future networking opportunities.

### ***Follow-Up Visit to the Buyer or Seller***

The broker-associate who calls on the customer after the closing demonstrates the careful attention needed to ensure that all details of the transaction have been completed satisfactorily.

### ***Notice of Closed Sale to the MLS***

Most MLS systems require that listing status changes be submitted as soon as possible. This provides brokers and broker-associates in the area with the most current information about listing availability and comparable sales information.

## **SUMMARY**

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The broker-associate's job really is just beginning when the parties sign the contract. Much work must be completed to ensure a successful closing. One of the first steps is to plan for each required task and enter it on a timeline. Each broker-associate and broker involved should agree about who must do what and when it must be done.

Licensees must complete tasks like attaching a contract pending sign, notifying the MLS, making the binder deposit, helping the buyer with the loan application, and taking care of inspections and repairs. A major part of the broker-associate's duties is reviewing the closing documents with the buyer or seller before closing.

## **APPLY WHAT YOU'VE LEARNED**

The following actions reinforce the material in Units 9 through 11.

- Select a three-bedroom home that is currently for sale that you would like to own. Calculate the PITI payment, assuming you pay the listed price and make a 10% down payment. Use current interest rates.
- Based on the previous action, divide the PITI payment by the mortgage amount. This will give you the mortgage payment factor, including taxes, insurance, and PMI. It will probably be just under 1%.
- Using the factor calculated previously, quickly figure the payment for a \$165,000 mortgage ( $1\% \times \$165,000 = \$1,650$ —quote just under that and estimate \$1,634). Now quickly estimate the PITI payments for the following mortgage amounts:

<b>Loan Amount</b>	<b>Payment (PITI)</b>
\$189,000	\$_____
\$238,000	\$_____
\$298,500	\$_____
\$212,000	\$_____

- Ask a title closing officer to show you the entire closing process (usually the end of the month is a bad time for this). Ask to watch a title search to see what the title company looks for. Examine the closing officer's checklist for closings. See what an instruction package from the lender looks like.

- With your employing broker's approval, randomly select five file folders for closed transactions. Thoroughly review each file and list every document in the file. Do some files seem more complete to you? Are there any that you believe are *not* complete? Check these against the firm's required documents list. Note which documents you want in all your closed files.
- Start again at the first file folder. Inspect the contract. Check to see whether the amount the sales associate estimated for the seller or buyer matched the actual amount on the Closing Disclosure form. Can you account for any material differences?
- Next, check every entry form for accuracy.
- If you have not yet had a closing, arrange with a broker-associate to attend another closing. Remember, you should listen, not talk, at the closing.

## APPENDIX

# B

## Analyzing Real Estate Investments

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › List the three basic categories of changes and trends in the economy
- › Itemize the four phases of an economic cycle
- › Name four advantages of investing in real estate
- › List at least four disadvantages of investing in real estate
- › Itemize five types of investment properties
- › Enter the major headings of an income property financial statement
- › List and calculate four important income property ratios; and
- › Itemize the three basic types of income tax deductions for investment property.

### KEY TERMS

annual mortgage	expansion	potential gross income
constant	gross domestic product	(PGI)
before-tax cash flow (BTCF)	(GDP)	random changes
contraction	$k$	recession
cycle	leverage	recovery
cyclic fluctuation	loan constant	reserves for replacements
dynamic risk	net operating income	seasonal variation
effective gross income	(NOI)	specific cycles
(EGI)	operating expenses (OE)	static risk

### OVERVIEW

Investment in real estate has produced a substantial portion of the wealth of our country and its citizens. Real estate licensees should be prepared to assist buyers and sellers of investment real estate. Consumers expect their broker-associates to have a basic understanding of the fundamentals of investment. An investment study includes analysis of the national and local economies, specifically as they relate to real estate.

Investing in real estate has advantages and disadvantages, and each investor must determine if an investment is suitable. This unit focuses primarily on investment opportunities in smaller income properties such as raw land and residential, office, and commercial properties.

Basic investment ratios help buyers analyze properties to help reduce risk. Several methods presented may help an investor use these ratios to determine the appropriate amount to offer for a property.

While federal income taxes are an important consideration when weighing an investment in real estate, the property's operating economics are more important.

## THE GENERAL BUSINESS ECONOMY

Timing is important in real estate investment. A good property purchased at the wrong time may result in substantial losses to the investor. Many investors also understand that a rapidly appreciating real estate market can make even marginal properties show acceptable returns. Before deciding which type of real estate is right, the investor must try to understand the current economic trends.

Trends in the business economy may either originate from or result in changes in the real estate market. The condition of one directly affects the condition of the other. Changes and trends in the general economy fall into four basic categories: seasonal variations, **cyclic fluctuations**, specific cycles, and random changes.

### Seasonal Variations

Changes that recur at regular intervals at least once a year are called **seasonal variations**. Such changes arise from both nature and custom. In the northern United States, for example, construction stops during the winter months; this seasonal change affects both the general economy and the real estate economy. Customs such as the nine-month school year have a seasonal effect on residential sales. Each year, the populations of mountain resorts increase during the ski season.

### Cyclic Fluctuations

Business cycles usually are defined as wavelike movements of increasing and decreasing economic prosperity. A **cycle** consists of four phases: expansion, recession, contraction, and recovery.

Production increases during **expansion** periods. High employment levels, wages, and consumer purchasing power increase demand for goods and services. Prices rise because of greater demand and credit is easy, making more money available for purchasing.

**Recession** is defined as two successive quarterly declines in the **gross domestic product (GDP)**. The GDP is the sum total of goods and services produced by the United States. The four major components of the GDP are consumption, investment, government purchases, and net exports.

**Contraction** begins immediately after recession. Confidence in the economy is shaken and consumers reduce spending in anticipation of lower earnings.

Slower sales cause reduced production, worker layoffs, and unemployment. Prices are reduced to clear out inventories of unsold goods.

**Recovery**, defined as two successive quarterly increases in the GDP, begins when consumers, lured by lower prices, venture back into the market. As business activity increases, confidence begins to return. Slowly, production facilities gear up to meet the new consumer demand, capital begins to flow back into business enterprises, and additional employees are hired. Finally, as the gradual rise in employment generates more spendable income and an increasing demand for more goods, the business cycle again enters the expansion phase.

Although business cycles technically consist of these four phases, most discussions deal simply with expansion and contraction, measuring expansion from trough to peak and contraction from peak to trough. Business cycles are recurrent, but not periodic; that is, they vary in duration and timing. Economists have observed that a complete cycle in the general economy may vary from 1 to 12 years in length.

## Specific Cycles

**Specific cycles** are wavelike movements similar to business cycles. They occur in specific sectors of the general economy, such as the real estate economy, and in individual sectors of the real estate economy, such as housing starts and real estate sales. Specific cycles do not always coincide with cycles of the general business economy, as the business cycle actually is a weighted average of all specific cycles.

Regardless of the state of the national economy, certain areas boom in recessions and stagnate in prosperous times because local demand runs counter to current broad economic trends. Colorado has long been affected by the cost of oil and gas, which has often created a boom and bust cycle.



### FOR EXAMPLE

Review the following selected headlines from a major business newspaper. Then, with a group of others, discuss what the likely effects will be on real estate investment properties, real estate brokerage firms, and other investment possibilities. Discuss which businesses will suffer in the near term and which will prosper.

Selected headlines in an inflationary economy include the following:

“Strong business expansion underway, may lead to inflationary pressures on the economy”

“General Motors reports quarterly sales increase of 22%. Stock price surges!”

“Current rate of inflation is \_\_\_\_\_%, expected to be at 9% within six months”

“Retail sales increase dramatically, paced by JC Penney, Wal-Mart, and The Limited”

“Federal Reserve Board raises discount rate  $\frac{1}{2}\%$ ”

“Economists foresee higher interest rates soon”

“Travel industry sees bumpy road ahead if oil prices increase substantially”

“‘Mortgage interest rates anticipated to rise to 12–14% in six months,’ warns Citibank economist”

“Inflation will continue for at least two years, according to Congressional Budget Office”

“Oil prices in the \$85 price range within two months, say industry sources”

## Random Changes

**Random changes** are irregular fluctuations of the economy that may be caused by legislative and judicial decisions or by strikes, revolutions, wars, fires, storms, floods, or other catastrophes. These changes, which are impossible to predict or analyze, may affect one or more sectors of the aggregate economy. They may influence all industries in an area or one industry nationwide. Real estate activity, especially construction, is very vulnerable to labor strikes, political changes, and natural disasters. One example of a random change in regard to real estate is a zoning ordinance change allowing undeveloped land to be used for industrial purposes that would stimulate construction activity locally. Government policy changes and changes in tax laws also can cause random changes in real estate activity on a nationwide scale. Investors must be aware of what is happening on both the national and local levels and have contingency plans to cope with events as they occur.

## THE REAL ESTATE ECONOMY

The real estate economy is an important component of the general business economy and is subject to the same four types of fluctuations. Specific cycles are the most pronounced and important trends that appear in the real estate sector. They can be observed in all phases of real estate: land development, building, sales, finance, investment, rental, and redevelopment.

Most sectors of the real estate economy are subject to both long and short cycles. Long-term cycles last from 15 to 22 years and short-term cycles last about 3 years.

A controlling factor in the building cycle is the availability of money and credit in the mortgage and construction markets. In general, when the economy is strong and prices are rising, the Federal Reserve tightens the money supply to control inflation. The resulting higher interest rates make real estate investment less attractive because builders must either pass the higher costs on to consumers or accept lower profits. Either situation slows the rate of construction. Conversely, interest rates decline during a recession, making the construction of new projects more feasible.

An extremely important indicator for forecasting the economy is the monthly report of housing starts published by the Census Bureau between the 16th and the 20th of each month. Housing starts, along with auto sales, are the first to rise in an economic recovery and the first to drop in a recession. Not only does new housing have a direct effect on the market, but housing-related purchases such as furniture and appliances also fuel a rebounding economy.

Building permit data is released with the housing starts report. Because permits are secured about a month ahead of construction starts, reviewing the increase or decrease in building permits gives a pretty good idea of what housing starts will do in the next month.

Once investors have satisfied themselves that the general economic situation is sound, it may be time to review the advantages and disadvantages of investment in real estate.

## REAL ESTATE INVESTMENT ANALYSIS

Most of the wealthy people in this country amassed their great fortunes from real estate investments. The most significant asset of most families is the equity in their homes. Real estate may not be the right investment for everyone, however. Advantages and disadvantages exist, and these should be evaluated by each individual.



## Advantages of Investing in Real Estate

The advantages of investing in real estate include leverage, good return, shelter from federal income taxes, and personal control of the asset.

### Leverage

**Leverage** is the use of other people's money to increase the investor's return. Few other investments offer the high leverage real estate does. Stocks and bonds typically require at least a 50% down payment; mutual funds want 100% invested. Yet, real estate investments can be made with a 25% down payment and, in many cases, less. The following example shows the benefits of leverage.



#### FOR EXAMPLE

Jack Gormley is considering the purchase of a duplex in an attractive neighborhood. He has reviewed the rental records for the previous four years that the property manager provided. The property's net income has increased about 4% annually. Property values have increased at about the same rate. The property value is \$100,000, with a \$20,000 down payment. Based on the new financing, Jack anticipates before-tax cash flows of about \$1,500 per year. He wants to compare this investment with a mutual fund that has averaged a 10% return over the previous five years. Assuming a holding period of five years and an annual property appreciation of 4%, how does the simple arithmetic look?

Property value at a 4% annual compound rate	\$121,665
Less mortgage balance at year 5	<u>− \$73,800</u>
Equals increase in equity	\$47,865
Plus \$1,500 per year for 5 years	<u>+ \$7,500</u>
Equals total cash from investment	\$55,365

The final figure averages \$11,073 for each year. Divided by the original investment of \$20,000, the average annual return is about 55%. The return from annual cash flows was only 7.5% ( $\$1,500/\$20,000$ ); the balance came from the increase in equity.

This type of analysis would be more accurate using the discounted cash flow approach, but the mutual fund returns would come in about the same pattern, making the comparison valid. Because of leverage, Jack's clear choice is the real estate investment.

### Good Returns

Many careful and astute investors achieve excellent returns, often exceeding 20%.

### Income Tax Shelter

Most investment opportunities such as savings accounts, bonds, stocks, and mutual funds require that the investor pay taxes on all current income (dividends). Real estate investments often provide tax-deferred cash flows, primarily because of cost recovery deductions (depreciation). This allows the investor to avoid paying taxes on the cash flows until the property is sold.

Exchanging and installment basis reporting are other ways to defer paying taxes. They will be discussed later in this section.

### ***More Personal Control***

Many investors are uncomfortable with the notion of entrusting their assets to other persons or companies and having little or no control over the use of those assets. The purchase of real estate gives an investor much more control over the investment's operation and management. This is true even if the investor employs a property manager, as the manager is under the investor's control.

## **Disadvantages of Investing in Real Estate**

Disadvantages of investing in real estate include management time, high capital requirements, poor liquidity, personal stress, and high risk.

### ***Management Time***

Along with the advantage of personal control comes the disadvantage of the amount of time required to manage the property. Continuing review and management of an income property's operations is absolutely essential. A prudent investor takes an active role in overseeing management. The investor must seek a higher return on the investment to compensate for the time requirements.

### ***High Capital Requirements***

Real estate requires a substantial capital investment. The investor needs funds to acquire the property and must have reserve funds available to make major renovations when required or to cover unexpected events. If vacancy rates are high, the investor will find it difficult to sell the property and may need to inject more money into the real estate to pay its operating costs and debt service to carry through the hard times.

### ***Poor Liquidity***

Investment real estate is a complicated purchase, even in the best markets. Land-use requirements, environmental audits, maintenance inspections, lease reviews, and new financing all take a substantial amount of time. A seller must understand that it could be a year or more after putting the property on the market before a sale is closed. In bad markets, however, it can be close to impossible to sell property at a fair price because so many other properties are available. This is a significant disadvantage of investment real estate.

### ***Personal Stress***

Many first-time real estate investors suffer rude awakenings when they discover that property management isn't just about cash flow projections and planning, but also about personal interaction with tenants. Because an owner's first few properties usually are not large or profitable enough to justify hiring a manager, the owner is left with the task. When the mortgage payment is due, slow-paying tenants can become an irritation. Tenant complaints take time and interpersonal skills to resolve. Tenants sometimes leave a property in poor condition when they move, requiring a large contribution of time and money to restore the premises for the next tenant. Eviction is sometimes necessary and is usually distressing to both landlord and tenant.

### **High Risk**

It is said that the longer an asset is held, the greater the chance of catastrophe. Many examples exist of seemingly good real estate investments gone bad. It could result from overbuilding in the market, causing high competition and lower rents. Environmental laws may require expensive retrofitting. Or a major employer may relocate to another area, causing widespread unemployment. Insurance does not cover this dynamic risk. To overcome **dynamic risk**, the investor must analyze a property carefully before purchasing, then manage it effectively.

**Static risk** is risk that can be insured. Examples include fire, windstorm, accident liability, floods, appliance contracts, and workers' compensation.

## **TYPES OF INVESTMENT PROPERTY**

A wide range of property is available for investment, and the type of property suitable for an investor often depends on the investor's age, assets, and risk profile. Young investors usually are willing to take greater risks. This may be due partly to optimism that has not been dimmed by hard knocks and partly to higher energy levels. Older investors want to keep what they have because they don't have a lot of time to get it back if it is lost. They avoid high risk and are more likely to look for attractive current cash flows as opposed to speculative appreciation.

Persons with very few assets have little to lose and are often risk-takers in their efforts to strike it rich. Persons who are financially comfortable usually are more conservative in their investment decisions.

Risk-averse investors ordinarily are not comfortable with industrial property, speculative land, or new construction of income property. They are more likely to want established income property with a proven record of income.

The types of investment property are raw land, residential income properties, office buildings, commercial properties, and industrial properties.

### **Raw Land**

Investment in raw land can be extremely profitable if good research skills, good instincts, and good luck come together in one transaction. This type of property investment also can be extremely risky for the novice investor. Cities and counties in Colorado, when trying to get a handle on growth guidelines, often change land uses in an area, which may have either wonderful or disastrous consequences for the investor. Income tax laws can change the feasibility of many projects. Raw land usually does not offer a cash flow to the investor and requires continuing infusions of funds to pay property taxes and interest on mortgages. Timing is important because the longer the property is held, the lower the rate of return tends to be.

The most important determinant of value for a vacant site is location. If land is planned for commercial use, it must have access and visibility from a major arterial road. Shopping centers should have easy access to expressways. Topography is important because it can affect building costs to correct for heavily sloping land.

## Residential Income Properties

A single-family home usually is the investor's initial purchase. A single-family rental home provides the investor with a breakeven cash flow or a little income if the investor combines good management with good luck. It also has some limited tax advantages from depreciation. Because the margins are so slim, however, a vacancy for even a month can wipe out all the profit for the year.

As the investor's assets and borrowing power grow, the next investment may be a multifamily property. Larger properties benefit from the efficiencies of land use and management. Where single-family homes usually are breakeven propositions for the investor, larger properties can bring substantially higher yields. Because of the much larger investment required, a buyer should make a complete and detailed investment analysis.

## Office Buildings

In the 1980s, office building construction was spurred on by the tax code and by infusion of capital into the market through limited partnerships. As a result, the office market became overbuilt in almost every major city and vacancy rates of 25% were common. Many of the buildings were economically unsound, and there were many foreclosure sales. The market finally began to recover in the late 1990s, and developers are building again. Lenders, however, still are cautious and demand strong financial statements and tenant commitment to ensure reasonable occupancy rates when the buildings are complete.

Small investors must analyze the office building market carefully before committing their funds. What is the competition? How many new buildings are permitted? What's happening in the area economy? It is not enough to look at the overall occupancy rate. An investor should segment the market by age, location, and amenities. It is possible that vacancies are high in the older downtown buildings, while newer suburban office parks are nearly full. Prestige office buildings can be unprofitable for the investor. They're really pretty, but often have low yields.

When analyzing the rent rates for competitive properties, the investor should pay careful attention to the services and tenant improvements included. Many buildings pay for utilities and janitorial service and give each tenant an initial allowance for partitioning.

Many investors prefer office buildings to residential apartments because tenants tend to occupy the properties longer, tenant complaints usually are made during business hours, and fewer collection problems occur. Smaller office buildings tend to have somewhat higher tenant turnover than buildings rented by national tenants.

## Commercial Properties

Many opportunities exist for small investors as well as shopping center developers to invest in commercial properties. Small strip shopping centers, because of their rectangular shape, lend themselves well to a variety of uses. They can be converted from storefronts to offices to restaurants with relatively little expense. A typical strip center consists of a 100- by-60 foot building with four 25-foot or five 20-foot wide bays. The market in many areas became very soft during the last economic downturn, making new construction loans difficult to obtain for some years. The market has improved in recent years, becoming attractive again to small investors.

Larger neighborhood shopping centers usually include a grocery store or a drugstore as the anchor, along with some personal service stores such as dry cleaners, laundromats, or restaurants.

Community shopping centers may include a Home Depot, Kmart, or Stein Mart as the anchor, along with a supermarket and other retailers, restaurants, and service companies. Management should try to arrange the mix of tenants so that each complements the others in the center; the overall effect is to generate additional traffic. Lease terms in these centers run longer than in strip centers. Professional property managers usually manage centers of this kind.

Regional shopping centers usually have three or more major department stores as anchors. They generally are located near expressways to draw more distant shoppers to the sites. The centers often have large numbers of general merchandise retailers. A professional manager is essential to enhance the value of this very large investment.

## Industrial Properties

Industrial properties usually are located near expressways, airports, seaports, or railroad lines. Investment in industrial property requires substantial research and carries significant risk. Most small investors should be wary about investment in this market. Many industrial properties serve special purposes and are subject to long periods of vacancy in market downturns. However, with a successful company as a tenant, an industrial property can achieve reasonable returns.

## MARKET ANALYSIS

Once the investor is satisfied that the economy is sound and begins to target the type of property for investment, a market study is the next necessary step. A regional market analysis should include demographic and economic information such as population statistics and trends, a list of major employers in the area, and income and employment data. It should explore the economic base of the city and prospects for the future in that locale. A neighborhood market analysis should assess five major factors:

1. *Boundaries and land usage.* Rivers, lakes, railroad tracks, parks, or major highways may help define the neighborhood's boundaries.
2. *Transportation and utilities.* Transportation and utilities are crucial to the success of income property. The investor should analyze the effect of major traffic artery changes, as well as proposed or scheduled widening of streets, opening or closing of bridges, or new highway construction, all of which may enhance or hurt a location.
3. *Local economy.* The investor also should review the neighborhood's economic health. Rental rates in the neighborhood are a sound indicator of the real estate market's economic strength. The investor can obtain the most reliable current rental rate information by shopping the competition.
4. *Supply and demand.* A high occupancy rate indicates a shortage of space and the possibility of rental increases. A low rate, as evidenced by many For Rent signs posted in the area, results in tenant demands for lower rents and other owner concessions.
5. *Neighborhood amenities and facilities.* The neighborhood's social, recreational, and cultural amenities can be important. Parks, theaters, restaurants, schools, and shopping centers attract potential tenants.

## FINANCIAL ANALYSIS

After analyzing the market, the investor must examine the property's financial performance. This provides the basis for estimating the property's value, based on return criteria the investor establishes. Assembling the data is the most time-consuming part of the analysis process. The investor must review the property's financial history, as well as rent data, financial results, and amenities for competing properties. The first step after assembling the data is to prepare a one-year financial statement for the property.

### Estimate Potential Gross Income

By multiplying the amount of space in the building by the base rental rate for that type of space, the investor can estimate rental income for each type of space found in the building. For example, the residential investor multiplies the number of studio, one-bedroom, and two-bedroom apartments by the rent for each type. The total of the estimated rent amounts from each type of space is the **potential gross income (PGI)** for the entire property.

### Estimate Effective Gross Income

**Effective gross income (EGI)** is potential gross income minus vacancy and collection losses plus other income. Vacancy and collection losses are forecast from the experience of the subject property and of competing properties in the market, assuming typical, competent management. A good balance of supply and demand is a 95% occupancy rate. Occupancy rates change based on changing economic conditions, such as rising unemployment rates or overbuilding. Other income from sources such as vending machines and laundry areas is added to potential gross income *after* subtracting vacancy and collection losses.

### Estimate Operating Expenses

The next step is to calculate the property's **operating expenses (OE)**. Operating expenses are divided into three categories: fixed expenses, variable expenses, and reserves for replacement (see the next paragraph). Ad valorem taxes and property insurance are examples of fixed operating expenses. Their amounts normally do not vary with the level of the property's operation. Variable expenses include items such as utilities, maintenance, trash removal, supplies, janitorial services, and management. These expenses are determined in direct relationship with the level of occupancy. Regional norms for these expenses are available through trade journals and professional property management associations.

### Establish Necessary Reserves for Replacement

If the level of expenses fluctuates widely from year to year, based on major maintenance and replacements of property components, it is difficult for the analyst to get a clear picture of typical expenses. To be meaningful, the expense figure must be stabilized. This is accomplished by establishing a **reserves for replacement** category of expenses. It is not a current cash outlay but an annual charge that should account for future expenses. The most accurate way to establish reserves is to divide the cost of each item and piece of equipment by its expected useful life in years.

## Estimate Net Operating Income

The **net operating income (NOI)** is obtained by deducting operating expenses (fixed, variable, and reserves) from effective gross income.

## Determine Before-Tax Cash Flow

Income properties normally are purchased with mortgage financing, so owners must make mortgage payments from the NOI. When an annual mortgage payment is subtracted from the NOI, the remaining amount is called **before-tax cash flow (BTCF)**, sometimes called *cash throwoff*.

## Constructing a Financial Statement for a Residential Investment

The following example describes the process of analyzing a residential investment. Sigrid Fleming is considering an investment in an apartment property. The property, which is about seven years old and well maintained, is located near some office buildings and shopping. Many of the tenants are employed in clerical and secretarial positions. The rental rates are very competitive in the area. Sigrid's broker has given her the bookkeeper's statements for the previous two years. Based on those statements and information from competing properties, she has constructed an operating statement.

## Ratio Analysis

Sigrid's next step is to prepare a ratio analysis that helps her evaluate different investment opportunities. Some of the important ratios include capitalization rate, equity dividend rate, cash breakeven ratio, and debt coverage ratio.

## Capitalization Rate

Capitalizing net operating income is a basic approach to estimating value. While an appraiser uses a rate determined by verified sales in the marketplace, an investor sets the rate that provides an acceptable return using subjective criteria the investor establishes. The capitalization rate is the one-year before-tax operating return on a real property investment without considering debt service on the property. If an investor pays all cash for a \$300,000 investment and the net operating income is \$30,000, the rate of return is 10%. This is calculated by dividing the net operating income by the value ( $\$30,000 \div \$300,000$ ).



### FOR EXAMPLE

What is the capitalization rate for the Villas Apartments?

If Sigrid desires a return of 14%, what will she pay for the property?

Assume, however, that the investor would not purchase the property unless it yielded 12%. By dividing the net operating income by the rate desired ( $\$30,000 \div 0.12$ ), the investor would agree to pay only \$250,000.



### Equity Dividend Rate

The equity dividend rate differs from the capitalization rate when a mortgage is considered in the analysis. If no mortgage exists, the capitalization rate is the same as the equity dividend rate. To calculate the equity dividend rate, divide the before-tax cash flow by the equity (value minus the mortgage).

Therefore, a property returning \$14,000 after the owner makes the mortgage payment and having equity of \$102,000 returns 13.7% on the equity ( $\$14,000 \div \$102,000$ ). This percentage sometimes is called the *cash-on-cash return*.

Many investors believe that the equity should return 50% more than current mortgage rates. If mortgages are currently 8%, for example, the investor should look for at least a 12% return.

Assume that the investor will purchase only if the property returns 16% on the equity. In that case, the investor would want to reduce the down payment from \$102,000 to \$87,500, determined by dividing the cash flow by the desired return ( $\$14,000 \div 0.16$ ). The price is determined by adding the down payment to the mortgage calculated originally.



#### FOR EXAMPLE

What is the equity dividend rate for the Villas Apartments?

If Sigrid desires a return of 16%, what down payment would she be willing to pay?

What price would she pay (add the down payment to the mortgage)?

### Differences Between the Capitalization Rate and the Equity Dividend Rate

If the equity dividend rate is higher than the capitalization rate, the investor has achieved positive leverage. If the equity dividend rate is lower than the capitalization rate, negative leverage exists. Investors want positive leverage.

In the Villas Apartments, positive leverage exists. The capitalization rate is 11.67%, and the equity dividend rate is 14.75%. The investor increased the return by borrowing money with a favorable repayment rate. The repayment rate is called the **annual mortgage constant**, with a symbol of  $k$ . The annual constant is calculated by dividing the annual debt service by the original mortgage balance. In the Villas, the annual debt service is \$87,235 and the mortgage is \$800,000;  $k$  is 10.9% (the interest rate is 10%, and principal amortization accounts for the balance). The rule then becomes simple: To achieve positive leverage,  $k$  must be lower than the capitalization rate.

### Cash Breakeven Ratio

This ratio is extremely important to the investor because it shows the level of occupancy required to generate enough revenue to make the required payments for expenses and debt service. It is calculated by dividing the cash outflows (expenses and debt service) by the potential gross income. The operating expenses should show only those expenses required to be paid in cash. Reserves for replacements usually are not a cash expense.



Assume that a small retail strip center has potential gross income of \$100,000; annual expenses of \$40,000, including \$4,000 in reserves for replacements; and annual debt service of \$47,000. What is the breakeven ratio? Divide the total cash expenses (\$40,000 – \$4,000 = \$36,000) plus the debt service by the potential gross income:  $\$36,000 + \$47,000 \div \$100,000 = 0.83$ , or 83%.

If all bays in the center rent for the same amount, the developer knows that the occupancy rate must be greater than 83% or the developer will have to use his own funds to make up the shortfall.



#### FOR EXAMPLE

What is the cash breakeven ratio for the Villas Apartments? What will be the impact on the owner if the vacancy rate is 20%?

### Debt Service Coverage Ratio

A lender is concerned if a property has net operating income that is too low to allow the owner to make mortgage payments easily. The lender wants a cushion so that even if vacancies or expenses increase, enough income will remain to make the mortgage payment. The debt coverage ratio demonstrates the amount of cushion. It is calculated by dividing the net operating income by the annual debt service.

Assume the strip center discussed earlier has a 5% vacancy rate, the net operating income is \$55,000, and the annual debt service is \$47,000. The debt service coverage ratio is 1.17. That means the net operating income is 117% of the amount needed to cover the mortgage payment (a 17% cushion). A lender feels more comfortable with a coverage ratio of at least 1.3.



#### FOR EXAMPLE

What is the debt service coverage ratio for the Villas Apartments? Does it appear to be adequate?

The ratios discussed earlier should not be used solely to report on a property's status. Astute investors use the ratios to help them determine the prices they would be willing to pay based on income and cash flows. For instance, assume the seller's broker provided the statement on the Villas Apartments. After Sigrid Fleming verifies the statement for accuracy and prepares the ratio analysis as described earlier, she may be prepared to make an offer on the property. The following format uses two calculations to assist in that process. The first calculation estimates the amount of mortgage loan that would be available; the second determines how much down payment the investor is willing to make. When the two figures are added, the result is the purchase price.

### Estimating the Amount of Available Financing Based on Lender Standards

To determine the financing, the investor needs to know the lender's requirements for the debt service coverage ratio and also needs to calculate the mortgage **loan constant** ( $k$ ) based on current lending rates. Dividing the NOI by the required debt coverage ratio generates the allowable annual debt service. Dividing that figure by the loan constant results in the available loan amount.

Assume that the mortgage market will allow a commercial building a 25-year loan at a rate of 8%. The monthly payment factor is 0.00772 and the annual factor is 0.09261. The second factor is  $k$ . With a net operating income of \$55,000, a required debt coverage ratio of 1.3, and an annual loan constant of 0.09261, the annual debt service can be \$42,308, as shown here:

1. Net operating income  $\div$  debt coverage ratio = annual debt service

$$\$55,000 \div 1.3 = \$42,308$$

2. Annual debt service  $\div$  mortgage loan constant = mortgage loan amount

$$\$42,308 \div 0.09261 = \$456,840$$

### **Calculating the Down Payment Based on Investor Return Standards**

The next step is to calculate the maximum down payment. Once the mortgage amount is determined, the investor subtracts the annual debt service from the net operating income to get before-tax cash flow. If the investor divides that figure by the required equity dividend rate, the result is the down payment the investor is willing to make.

In the previous example, we estimated that the debt service allowed by the lender is \$42,308. The net operating income is \$55,000. Deducting the debt service of \$42,308 results in a \$12,692 cash flow. If the investor's required return is 15%, the down payment would be \$84,613, as shown here:

1. Net operating income  $-$  debt service = before-tax cash flow

$$\$55,000 - \$42,308 = \$12,692$$

2. Before-tax cash flow  $\div$  required rate of return = down payment

$$\$12,692 \div 0.15 = \$84,613$$

### **Calculating the Purchase Price**

Once the previous two steps are complete, the purchase price is simply the addition of each figure. Continuing the same example, the calculation is as follows:

Mortgage amount available from lender	\$456,840
Plus down payment from buyer	<u>+ 84,613</u>
Equals purchase price offered	\$541,453

This technique for valuing income property is superior to simply capitalizing net income.

### **Other Financial Analysis Techniques**

More sophisticated discounted cash flow techniques require the use of financial tables or a financial calculator and include the *net present value*, the *internal rate of return*, and the *financial management rate of return*. In general, after-tax cash flows for future periods, including sales proceeds, are discounted back to the present value so that the pattern of receipts does not distort the analysis. While these techniques are important tools, they are beyond the scope of this text. The material is covered more fully in broker's courses and in commercial and investment real estate classes.

## FEDERAL INCOME TAXES AND REAL ESTATE INVESTING

Real estate investors should not purchase property solely because of tax considerations. Many remember the large losses suffered by those who did so and were ruined financially by the 1986 Tax Reform Act. However, careful tax planning may help to maximize an investor's return on certain investments and should be considered when weighing alternative investments.

Income property owners enjoy certain tax advantages other investors do not. An owner is allowed three types of deductions from gross income when calculating taxable income from investment property: operating expenses, financing expenses, and depreciation.

Operating expenses include those cash outlays necessary for operating and maintaining the property. Financing expenses include interest on indebtedness and amortization of the costs of borrowing money, such as discount points.

Depreciation deduction is not related to the depreciation used in appraising, which is based on realistic improvement lives. This is an arbitrary method of allowing the investor to recover the cost of improvements over a specified period. Costs of residential income property may be recovered over a life of 27.5 years, and nonresidential income property may be written off over 39 years. For example, if a person bought a duplex three years ago for \$125,000, paid closing costs of \$5,000, and obtained an appraisal showing that the building was worth 80% of the total, what is the depreciation deduction?

To determine the deduction, first allocate the acquisition costs to the building and the land, then divide the building's acquisition costs by the applicable depreciable life. The \$125,000 purchase price plus the \$5,000 in closing costs equals the acquisition cost of \$130,000. Because the building is worth 80% of value, the building's depreciable basis is \$104,000. Residential property is depreciated over 27.5 years, so \$104,000 divided by 27.5 years equals a deduction for this year of \$3,781.81.



### FOR EXAMPLE

If closing costs on the Villas Apartments are \$12,000 and the improvements are estimated to represent 75% of the total value, what is the depreciation deduction?

## Tax-Deferred Exchange

While the new capital gains rates are attractive, most investors attempt to defer (not eliminate) paying any taxes by exchanging the property for *like* investment property. Like investment property includes real estate such as vacant land, residential income property, commercial income property, or industrial income property.

The rules do not require a barter of property. A person may sell investment property, escrow the proceeds out of his personal control, then identify another property to buy within 45 days, closing within 180 days.

## Installment Basis Reporting

Taxes on the gain from the sale of a property need not be paid at once if the seller does not receive the proceeds in the year of sale. The law allows the taxpayer to pay taxes on the gain as the seller receives the proceeds. No minimum or maximum down payment is required. A loss on sale may not be reported using installment basis reporting.

## SUMMARY

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Real estate licensees are quite active in marketing investment properties. Most small investors concentrate initially on small residential properties but later may investigate the opportunities in the office and commercial markets.

An understanding of the general business economy is helpful in timing investment decisions. If the market is at the top of the cycle, buyers should be wary, but sellers might wish to market their properties aggressively. Specific cycles are the most important cycles that affect the real estate market. Low interest rates are a critical component to a strong real estate market.

Real estate investing offers many advantages, such as leverage, good returns, tax shelters, and personal control. However, those advantages are tempered by problems with stress, management time, risk, and poor liquidity.

After analyzing the market, an investor must prepare a careful financial statement, together with meaningful ratios. The investor can use the ratios to help determine what price to offer for the property.

Licensees have an opportunity to help their customers take one of the most important steps of their lives—beginning a program of real estate investment.

## APPENDIX

# C

## Professional Property Management

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to accomplish the following.*

- › Describe the general duties of professional property managers.
- › List the four major classifications of rental properties.
- › List at least six important elements of a management contract.
- › List the four major property maintenance categories.
- › Describe the requirements that determine the need for an on-site maintenance staff, contract services, or a resident manager.
- › Describe the differences between a property manager and a resident manager.
- › List at least three different advertising media that help to market rental property.
- › Describe the uses and benefits of a show list.
- › Identify at least five of the essential elements of a valid lease.
- › Identify and explain the purpose of three of the financial reports an apartment building owner needs.

### KEY TERMS

cash flow report	deferred maintenance	preventive maintenance
Certified Property Manager (CPM)	Institute of Real Estate Management (IREM)	profit and loss statement
contract service	new construction	resident manager
corrective maintenance	maintenance	routine maintenance
		show list

### OVERVIEW

Investors generally agree that professional property management is the key to maximizing their returns. The professional property manager must have a comprehensive understanding of the economic forces at work in the real estate market and must be able to evaluate the property in terms of operating income, forecast its potential for the future, and construct a management plan that reflects the owner's objectives. The property manager must become a specialist skilled

in space marketing, tenant psychology, the legal aspects of the landlord-tenant relationship, maintenance procedures, and accounting. This unit examines these topics.

## INTRODUCTION TO PROPERTY MANAGEMENT

A professional property manager may be an individual licensee, a member of a real estate firm specializing in property management, or a member of the property management department of a large full-service real estate company. The professional property manager also may work within the trust department of a financial institution or within the real estate department of a large corporation or public institution. Regardless of their employment status, property managers pursue similar objectives and handle a wide variety of duties, including planning, merchandising, maintenance, and accounting. Although management duties vary according to the specific situation and particular property, a successful manager is competent in all of these areas.

**Remember:** A broker-associate must have the permission of her employing broker to manage property. The employing broker will set up the trust accounts and will sign the management agreement.

The **Institute of Real Estate Management (IREM)** was created in 1933 by a group of property management firms as a subsidiary group of the National Association of REALTORS®. Currently, an individual wishing to join the institute must satisfy education and experience requirements, pass examinations given or approved by the institute, and adhere to a specific code of ethics. The individual is then awarded the prestigious designation **Certified Property Manager (CPM)** in recognition of reaching professional status as a property manager.

## CLASSIFICATION OF REAL PROPERTY

Real estate property managers manage four major classifications of real property: residential, commercial, industrial, and special-purpose. Each classification can be further subdivided and requires a different combination of property management knowledge and skills. This unit introduces the field; it is not intended to be a complete discussion of property management. Residential property is emphasized in this introduction.



### FOR EXAMPLE

Relate a personal experience in renting or leasing residential property as a landlord or tenant.

## Residential Property

Residential real estate is the largest source of demand for the services of professional property managers. Two principal categories of residential real estate exist: single-family homes and multifamily residences.

### Single-Family Homes

Freestanding, single-family homes are the most popular form of housing in the United States. According to the Census Bureau, more than 60% of housing in this country is owner-occupied and does not require professional management. Although homes that are rented to other parties often are managed directly by the owners, there is a growing trend toward

professional management of such properties, particularly condominiums and vacation homes. Many large corporations and their relocation companies hire property managers for homes vacated by employees who have been transferred.

Rising construction costs and a decrease in the availability of usable land have resulted in the growing popularity of town houses, condominiums, and cooperatives. Although each unit is a single-family residence, the individual owners of the units share certain responsibilities, such as maintenance of the roof, common walls, grounds, and common facilities, for the development as a whole. They usually employ professional managers to handle these jobs and maintain accounting records.

### ***Multifamily Residences***

The economy of design and land usage inherent in multifamily housing allows for a lower per-family cost of construction. Thus, multifamily residences are a rapidly growing segment of the national residential real estate market.

Multifamily residences can be held under various forms of ownership. Small properties of two to six units often are owner-occupied and ownermanaged, whereas most large highrise apartment communities are professionally managed for their owners. Cooperative and condominium apartments usually are owner-occupied buildings governed by boards of directors the owners elect. These boards generally hire professional managers for their properties.

Multifamily residences can be classified as garden apartments, walkup buildings, or highrise apartments. Each type is unique in its location, design, construction, services, and amenities.

### **Owner-Broker Relationship**

Three basic relationships can exist between the individual or corporate owner of a building and the property manager: owner-broker, employer-employee, and trustor-trustee. Property managers in all categories are considered professionals and their responsibilities are very similar. Because this section focuses on residential property management, only the principal-agent relationship is covered here.

Usually, when an owner engages a broker to be the property manager the broker acts as a single agent for the owner. The principal-agent relationship is created by a written contract signed by both parties that empowers the property manager, as agent, to act on behalf of the owner, or principal, in certain situations. Specifically, the agent acts for the principal to bring the principal into legal relations with third parties. Implicit in this fiduciary relationship are the legal and ethical considerations that any agent must accord to the principal. The property manager has the duties of skill, care, diligence, obedience, loyalty, accounting, disclosure, and confidentiality. Typically, the property manager is considered to be a general agent for the principal.

## **THE MANAGEMENT CONTRACT**

Once the property manager and the owner have agreed on principles, objectives, and a viable management plan, it is in both parties' best interests to formalize their accord. The manager and the owner must work out the structure of their relationship, their specific responsibilities and liabilities, the scope of the manager's authority, management fees, and the duration of the management agreement. In addition, the owner must turn over management records and other information to the manager to facilitate the property's operation.

Whether the property involved is a duplex or a highrise complex, the responsibilities the manager assumes are of enough importance to warrant a written statement of intent. An agreement signed by both the manager and the owner defines the relationship between the parties, serves as a guide for the property's operation, and helps prevent misunderstandings. The terms of a management contract vary, but most share the following essential elements:

- Identification of the parties and the property
- The term of the contract
- Responsibilities of the manager
- Responsibilities of the owner
- Fees and leasing/sales commissions
- Signatures of the parties

## PROPERTY MAINTENANCE

Maintenance is a continual process of balancing services and costs in an attempt to please the tenants, preserve the physical condition of the property, and improve the owner's long-term margin of profit. Efficient property maintenance demands careful assessment of the status of the building's condition. Staffing and scheduling requirements vary with the type, size, and regional location of the property, so the owner and manager usually agree in advance on maintenance objectives for the property. In some cases, the owner instructs the manager to reduce rental rates and expenditures for services and maintenance. Under this shortsighted policy, the manager may encounter management problems and the manager's reputation may be affected adversely. Properties can command premium rental rates if they are kept in top condition and operated with all possible tenant services.

### Types of Maintenance

The successful property manager must be able to function effectively at four different levels of maintenance operation:

- Preventive maintenance
- Corrective maintenance
- Routine maintenance
- New construction maintenance

**Preventive maintenance** is aimed at preserving the physical integrity of the premises and eliminating corrective maintenance costs. Regular maintenance activities and routine inspections of the building and its equipment disclose structural and mechanical problems before major repairs become necessary.

**Corrective maintenance** involves the actual repairs that keep the building's equipment, utilities, and amenities functioning as contracted for by the tenants. Fixing a leaky faucet and replacing a broken air-conditioning unit are corrective maintenance activities.

**Routine maintenance** is the most frequently recurring type of maintenance activity. Common areas and grounds must be cleaned and patrolled daily. Also, cleaning and housekeeping chores should be scheduled and controlled carefully because such costs easily can become excessive.



**New construction maintenance**, linked closely with leasing and tenant relations, is designed to increase the property's marketability. This may be as elementary as new wallpaper, light fixtures, and carpeting. If the new construction is extensive, it might include new entryways, the addition of a swimming pool, conversion of space to a meeting room, or renovation of a previously occupied space. New construction often is performed at a tenant's request and expense. Sometimes a landlord redecorates or rehabilitates a space for a tenant as a condition of lease renewal.

**Deferred maintenance** is necessary maintenance that cannot or will not be performed. Deferred maintenance results in physical deterioration, unhappy tenants, and reduced rent collections.

### On-Site Maintenance Staff

The manager's hiring policy for on-site maintenance personnel usually is based on the cost differential between maintaining a permanent building staff and contracting for the needed services. For example, the amount of construction activity stemming from alterations tenants require determines the hiring policy. It makes sense to hire outside contractors for major construction jobs or for small buildings that cannot support permanent staffs.

The Building Owners and Managers Institute (BOMI) sponsors instruction that leads to professional designations for maintenance personnel and supervisors. These courses are particularly instructive for on-site maintenance personnel. Property managers who wish to learn more about the technical and mechanical aspects of their properties will find these courses a good source of information.

### Contract Services

Services performed by outside persons on a regular basis for specified fees are known as **contract services**. For the protection of both the manager and the owner, a service contract always should be in writing and contain a termination provision. The latter stipulation becomes important if service is not satisfactory or if the property is sold.

Before entering into any service contract, the manager should solicit competitive bids on the job from several local contractors. The manager can then compare the cost of contracting with the expense of using on-site personnel. The management agreement terms often set a ceiling on the service contracts the manager can execute without owner approval. Window cleaning, refuse removal, pest control, and security are services that usually can be performed more efficiently and inexpensively by outside contractors. The manager should check a contracting firm's references and work history before employing them. The manager should determine whether the firm's employees are bonded and whether it has the necessary licenses or permits.

## RESIDENT MANAGER-PROPERTY MANAGER RELATIONSHIP

Most properties of 20 units or more have a manager on the premises at all times. This **resident manager** is a salaried employee who usually coordinates rent collection, tenant relations, and maintenance work on the property. Obviously, these responsibilities increase with the building's size. The resident manager reports to the property manager. With this system, a single property manager can stay current with the operations of several large apartment properties without becoming consumed by the details. In addition to reviewing the reports submitted by resident managers, the property manager should visit each building regularly to gather information on necessary maintenance and repairs. Periodic inspections

show the property manager how occupancy rates may be increased, indicate where operating costs can be cut, help improve tenant relations, and provide training and feedback reviews to the on-site manager.

In the past, building superintendents not only collected rents but also served as the maintenance staff. As the property management field grows more sophisticated and building equipment becomes more complicated, managers who perform all four maintenance functions have become the exception rather than the rule. Property managers are expected to recognize when maintenance is necessary and know where to turn for help with specific maintenance problems. While a property manager need not be a jack-of-all-trades, he should understand the basic operation of mechanical and electrical systems well enough to make intelligent decisions about their care and operation. The managers also must understand the economics, staffing, and scheduling involved in the smooth performance of maintenance tasks.

The hiring and firing of employees should be under the control of the property manager, not the resident manager. When screening a potential employee or making a decision to terminate an employee, the property manager should ask for the resident manager's opinion of the person's integrity, industry, and skills.

## MARKETING THE SPACE

Two basic principles of marketing are "Know your product" and "Your best source of new business is your present customer base." Thorough preparation is required to give a suitable presentation of the premises as well as to determine such items as rental rates and advertising methods necessary to attract tenants. Maximum use of referrals from satisfied tenants is the best and least expensive method of renting property and is essential to any marketing effort.

It is the property manager's responsibility to generate the maximum beautification and functional utility per dollar spent. Items such as an attractive lobby, well-landscaped grounds, and the use of pleasant colors inside and outside the building may not create greater functional utility, but they may increase marketability and profitability.

Rental space is a consumer good that can be marketed with promotional techniques like those used to sell cars or homes. Because most apartment renter prospects come to the property as a result of a neighborhood search, attractive signage and strong curb appeal is essential. Each residential property should display a tasteful sign on the premises identifying the community, the management firm, the type of apartment, the person to call for further information, and a telephone number. However, walk-ins alone will not supply all the prospects needed. Other types of advertising also are necessary to attract qualified tenants.

### Advertising and Display

Even if the property is priced at the appropriate market level, the premises are clean and attractive, and the property has a good location, the building still may experience an unacceptable vacancy rate if prospective tenants are not attracted to inspect the premises. The most common advertising is newspaper classified and display ads and apartment guides. The broker should be careful to observe fair housing laws and restrictions when advertising and to discuss the house and not who should live there. Colorado license law requires that the brokerage name appear in all advertising.

## ***Classified Ads***

Newspaper classified advertising is the most important advertising medium for renting apartments. The property manager must keep the prospective tenant's needs in mind when composing the ad. For example, in a neighborhood where three-bedroom apartments are difficult to rent, an ad may appeal to a broader segment of the market if it offers a two-bedroom apartment with den. The classified advertisement should include the amount of rent, apartment size, property address, and manager's phone number. A brief summary of the property's major amenities also is very effective.

## ***Display Ads***

More prestigious residential projects, especially when newly built, find it advantageous to use display advertisements. These larger ads attract immediate attention, appeal to potential tenants' desire for attractive living space, and demonstrate the many amenities a building offers. The specific rental rates often are omitted, with reference to a general range.



### **FOR EXAMPLE**

Find a copy of the entire classified ad section of your local newspaper. Examine the sections dealing with display ads for large residential properties and compare various ads' effectiveness. Also, examine the help wanted sections for property and resident managers.

## **Apartment Guides**

Just as homes magazines are one of the most effective ways to market residential homes for sale, apartment guides appeal to potential tenants. Color photos make the property's presentation attractive and interesting. Many management firms report that the excellent response to ads in the guides is beginning to rival the effectiveness of newspaper classified advertising.

## **Broker Cooperation**

While the ultimate objective of all selling activities is closing the sale or lease with the ultimate user, the property manager will want to take advantage of all opportunities for reaching customers. This means that sales efforts should be directed not only toward prospective buyers and tenants but also toward brokers and agents who can reach rental prospects.

Broker cooperation can be especially helpful when renting or leasing a new or very large development. Managers secure that cooperation by sending to key brokers brochures or newsletters describing available properties. Compensation usually is a split commission or referral fee. A manager also can make brokers aware of a property by making a personal presentation or by sponsoring an open house.

## **Rental Rate Strategy**

Even when the space itself is clean, attractively decorated, and in good condition, market conditions may be such that some units cannot be leased. An alert manager quickly realizes which units are renting rapidly and which are not moving fast enough and either adjusts the price or changes the method of advertising and display.

The goal in establishing a rental fee schedule is to realize the maximum market price for each unit. If each apartment type is priced correctly, all types will have the same rate of demand; that is, demand for studio, one-bedroom, and two-bedroom units will be equal, and the manager will be able to achieve a balanced occupancy rate for all three types. However, this level of demand is the exception in the real market. More often than not, the manager will have to raise the base rent on the unit types that are fully occupied and decrease the rate for those units less in demand. An optimal price structure ensures a 95% occupancy level for all units. For this strategy to be economically sound, the revenue from the new 95% schedule must exceed the income that was collected when some types of units were fully occupied and others had tenant levels less than 95%. The optimum rental rates in a local market are best determined by market analysis.

## Show List

To establish a reasonable rental price schedule like the one outlined earlier, the manager must follow certain organizational procedures, such as compiling a **show list**. This show list should designate a few specific apartments in the building that are currently available for inspection by prospects. No more than three apartments of each type and size should be on the list at any one time; when a unit is rented, it should be replaced by another vacated apartment that is ready for rental.

The manager should use the show list both as a control guide for the marketing program and as a source of feedback on its success or failure. The features of particular units are itemized on the list so that the manager can do a better and more informed selling job. The maintenance staff will have no problem keeping a small number of vacant units on the list in top-notch condition. The limited number of show units also suggests that space is at a premium and that the prospective tenant must make a decision quickly.

The show list and traffic count should be reviewed weekly to determine which units are not moving. Particular units may not rent even after several showings to prospects. The manager then should inspect these units personally to find out why they are hard to rent. All curable flaws (for example, worn carpeting or obsolete fixtures) should be corrected. If poor curb appeal is the problem, painting or cleaning up entranceways, planting new landscaping, cutting grass, and trimming shrubs often works wonders.

It is important that fair housing laws be observed carefully. The limited show list must never be used as a method of illegal steering within the property.

## Selling the Customer

The best advertising programs, landscaping, decorating, and maintenance may be wasted if the rental agent is unresponsive or unprofessional or does not properly show the property. One of the most important ingredients in achieving occupancy targets is a well-trained rental staff who are personable, enthusiastic, and professional. Many large management organizations spend substantial time and money to ensure that rental agents have the technical knowledge and sales skills to best represent the property owner. The property manager should maintain records carefully, including guest books to record visitors' names. The rental agent should describe the result of each visit and record subsequent follow-up calls.

## LEASES AND TENANT RELATIONS

Potential conflicts between property managers and tenants usually can be avoided when sound property management practices are employed. Sound management begins with negotiation between the property manager and the prospective tenant, the results of which should be in written form (the lease).

### Essentials of a Valid Lease

The general requirements for a valid lease are similar to those for any legally enforceable contract:

- Complete and legal names of both parties (lessor and lessee)
- Legal description of the property
- Contractual capacity of the parties and legal purpose of the agreement
- Consideration or amount of rent
- Term of occupancy
- Use of the premises
- Rights and obligations of the lessor and lessee
- In writing and signed (if for more than one year)

Colorado does not have an approved lease form, so licensees should use standard leases or one drafted by the owner, the owner's attorney, or the brokerage firm's attorney. The manager should explain the key points in the lease agreement. Rent collection policies should be covered. Tenants will usually pay rent promptly if the collection policy is efficient, effective, and reasonable. The manager should itemize other regulations that control the property and discuss the methods of enforcing them. The manager must be certain that the tenant understands maintenance policies and how responsibilities are divided between landlord and tenant. These policies and procedures are often outlined in a tenant brochure.

Most tenant-management problems center on maintenance service requests. When such a request is made, the tenant should be told immediately whether it will be granted. The tenant is the customer, not an adversary, and the staff should be reminded of that fact continually. Happy tenants remain in residence, eliminate expensive turnover, protect the owner's property (which lowers maintenance costs), and promote the property's reputation (which reduces vacancy losses and promotional expenses).

A tenant request for service should be entered on a standardized request form. The top copy and a copy to be left in the unit on completion of the work are assigned to the maintenance person answering the request. The manager keeps the third copy until the job is completed. An estimated completion date should be entered on the manager's copy for follow-up. The resident manager should contact the tenant to ensure that the work was completed properly.

## OPERATING REPORTS

Owners of residential rental apartments need current operating reports to measure the profitability of their investments. The annual operating budget, cash flow statement, and profit and loss statement give an owner the data necessary to evaluate the property and its management.

## Operating Budget

The property manager must prepare a meaningful annual operating budget that includes all anticipated income and expense items for the property. The starting point for this year's budget most often is based on the actual data from the previous year. The annual budget is helpful as a guide for overall profitability. It must, however, be broken down into monthly budgets if it is to be useful for controlling operations. There, the manager should produce monthly statements that compare actual and budgeted amounts and should be able to explain any significant variations.

## Cash Flow Statement

Probably the most important operating record is the manager's monthly **cash flow report** on receipts and disbursements. This report includes all operating income, such as the income from parking, washing machines, dryers, and vending machines, and all operating expenses and debt service. The reports show the owner how the property is doing on a cash basis. The report also can include the annual budget as well as the previous year's results, providing a budgetary control and a cash control.

## Profit and Loss Statement

A **profit and loss statement** is a financial report of a property's actual net profit, which may differ from the cash flow. The full mortgage payment is not shown; only the interest payment is an expense. The manager usually prepares a profit and loss statement quarterly, semiannually, and yearly. Monthly income and expense reports provide the raw data for these statements. The more detail provided in the report, the better the opportunity for meaningful analysis.

## Additional Reports

Managers must be completely familiar with all phases of a property's operation. Other reports, such as vacancy ratios, bad-debt ratios, showings-to-rent ratios, and changes in tenant profiles, illustrate important trends that may require corrective action. Scrutiny of the budgets and actual expenditures per account from month to month and year to year can indicate the relative performance of management personnel.

## LICENSING REQUIREMENTS IN COLORADO

Property managers, in general, must be licensed in Colorado. However, a regularly salaried on-site manager who reports to the owner or broker who manages the property need not be licensed. An unlicensed on-site manager may not negotiate the lease or other terms with tenants.

## SUMMARY

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When an owner hires a manager, the parties enter into one of three relationships: principal-agent, employer-employee, or trustor-trustee. Most management contracts share six basic characteristics and specify the duties and details of management operations that must be decided before responsibility for the property is transferred to the manager.

To handle the property's maintenance demands, the manager must know the building's needs and the number and type of personnel required to perform the maintenance functions. Staff and scheduling requirements vary with a property's type, size, and regional location.

Four types of maintenance operations exist: preventive maintenance, corrective maintenance, routine housekeeping, and new construction. Deferred maintenance is the term applied to accumulated postponed maintenance.

The hiring policy for on-site maintenance staff depends on the cost differential between maintaining a permanent building staff and contracting for needed services. A particular property's circumstances dictate which alternative is more efficient and economical.

Multifamily dwellings differ from one another in size, structure, location, and number of amenities provided. These differences exert a direct influence on the advertising techniques used to market each type of space. A show list of units available for inspection also is important to a property manager's marketing program, as is newspaper advertising, the most widely used medium for renting space because it reaches a large audience.

In addition to leasing, supervising the resident manager, and inspecting the maintenance of the premises, the property manager must provide the owner with regular financial reports. Various financial statements provide the owner with the data necessary to evaluate the performance of the manager and the property itself.





# APPENDIX

# D

## Answers to Lecture Outline Fill-Ins, Glossary Reviews, and Case Studies

*Answers are listed in the order of their appearance on the page.*

### **Unit 1: Current Legal Issues**

#### PAGE 12

written  
respond to the complaint  
subpoena records  
letter of admonishment  
censure

#### PAGE 13

approved forms  
assist brokers  
brokers use approved forms  
compliance  
resulting from negotiations  
may not

#### PAGE 14

negotiations  
the broker or brokers  
exactly  
prior to negotiation  
new homes with warranties  
specific transaction  
general use in the firm

#### PAGE 15

does not have to disclose  
list the method used  
list the source  
seller's current actual knowledge  
buyer signs  
do not fill out the form  
familial  
race  
sex  
handicap  
color  
religion  
national origin

#### PAGE 16

marital status  
sexual orientation  
steering  
redlining  
blockbusting

### **Unit 2: Real Estate Brokerage in Colorado**

#### PAGE 37

less than two years  
may not hire or supervise  
is qualified to hire and supervise

must have a written agency contract  
single agent

PAGE 38

agent  
advocate  
acts like a coach  
an agent or advocate  
both sides  
acting as a referee  
default  
confirmation  
no brokerage relationship  
not engaged or employed any broker

PAGE 39

writing  
represent  
agency  
transaction brokerage  
written office policy

PAGE 40

unrepresented customer  
mandatory  
compromise

PAGE 41

Commission rules  
brokers disclose in writing  
confidential information  
might

PAGE 42

must  
signed to be in compliance  
*in writing with signed*  
sign it  
owns the listing contract  
employing broker  
brokerage relationship  
designated associate broker  
must be in writing

PAGE 44

assist brokers  
compliance

PAGE 45

different typeface  
resulting from negotiations  
may not  
does not result from the negotiations  
broker or brokers

PAGE 46

exactly  
negotiation  
new homes with warranties  
general use

**Unit 3: The Seller and Buyer Relationship**

PAGE 57

employs  
pays

PAGE 58

agency or transaction-broker  
commission  
cannot be designated

PAGE 59

must sign  
the brokerage firm  
voluntary  
obligates

PAGE 60

definite date  
negotiable

PAGE 61

breach  
at the same time  
material facts

PAGE 62

informed  
the seller's or buyer's permission  
state  
permission

PAGE 63

verify the accuracy or completeness  
not allowed to disclose  
their brokerage firms

PAGE 65

both listings  
negotiated  
rebate  
renegotiation

PAGE 66

written permission  
title company  
exclusive

PAGE 68

immediately

PAGE 70

financial protection  
net proceeds  
income tax liability

PAGE 71

excluded in  
bill of sale

PAGE 72

at or before closing  
assume  
seller

PAGE 73

known material defects  
buyer  
seller is responsible  
building permit

PAGE 75

negotiations  
seller  
current listing expires  
holdover period

**Unit 4: Colorado Contract to Buy and Sell Real Estate**PAGE 86

*inclusions and exclusions*

PAGE 88

address  
excluded in the contract  
deed  
included in the offer  
bill of sale  
conveyed with the title  
deed

PAGE 89

only place

PAGE 90

residential  
MLS  
Personal checks  
noted  
acceptance of the offer  
immediately  
sale

PAGE 93

may not share  
terminates  
less than

PAGE 94

negotiate  
mandatory assessment  
waive the right to object

PAGE 95

obligation  
right

PAGE 96

financial  
enter and use the property

**Unit 4: Colorado Contract to Buy and Sell Real Estate, continued**PAGE 97

actual knowledge

PAGE 98

on the resolution deadline listed  
terminates the contract

PAGE 99

building permit issued  
seller's obligation

PAGE 100

proceeds from the sale

PAGE 101

negotiated  
one cent per 100 dollars (0.01 per \$100)  
buyer  
prorate to the day of closing  
prorated  
statutory

PAGE 102

10%

PAGE 103

inspection

PAGE 104

specific performance  
specific performance  
30 days  
the brokerage firm

PAGE 105

buyer within 120 days

PAGE 106

withdraw

PAGE 107

must change

PAGE 108

not a contract

**Unit 6: Additional Transaction Documents and Regulations**

PAGE 121

seller  
The seller provides  
waive the inspection

PAGE 122

residential  
describe the method  
or  
unreliable  
not for loan, valuation, or other purpose  
obvious mismeasurement  
buyers  
seller  
broker  
residential

PAGE 123

designated brokers  
closing entity

PAGE 124

terminates  
blank

PAGE 125

inspection objection deadline  
final agreement

PAGE 126

only  
closing date  
be signed before the date  
buyer or seller listing  
listing designated broker  
employing broker

PAGE 127

listing designated broker  
employing broker  
interest  
seller friendly  
no obligations  
pays no commission  
signs on the line

PAGE 128

ensure fair and uniform  
personal property  
not an appurtenance  
doctrine of prior appropriation  
beneficial

PAGE 129

irrigation  
 state engineer  
 does not  
 public trustee  
 nonjudicial  
 private trustee  
 judicial foreclosure

PAGE 130

advertises  
 right to cure  
 110 days  
 125 days  
 215 days  
 230 days  
 deficiency judgment

PAGE 131

may  
 usury

PAGE 132

prescriptive interest  
 last day of February  
 June 15  
 April 30

PAGE 133

three years  
 20 or more lots  
 sold for residential  
 Campsites  
 PUD  
 reasonable level  
 reviewing contracts  
 high level  
 withholding status

PAGE 134

must have a written contract stating  
 must withhold  
 active brokers  
 licensed  
 renewed every year

PAGE 135

sign checks  
 office manager

### Unit 6: Fair Housing, Property Management, Leasing, and the Law

PAGE 140

one year  
 two years

#### Fair Housing Act Comparison

FEDERAL	COLORADO
<b>Protected Classes</b>	
Prohibit discrimination based on	
F <u>Familial status</u>	Same
R <u>Race</u>	Same
equal	
S <u>Sex</u>	Same
H <u>Handicap</u>	Same (called disability)
C <u>Color</u>	Same
opportunity	
R <u>Religion</u>	Same (also creed)
N <u>National origin</u>	Same (also ancestry) adds <u>marital status</u> and <u>sexual orientation</u>

**Property Included**

Residential only Commercial and residential

**Enforced By**

HUD and federal courts Colorado Civil Rights  
 Commission and state courts

PAGE 141

reversible modifications

PAGE 142

high-quality  
 environmental issues

PAGE 143

Broker associates  
 within one month  
 for treble (triple)  
 four years  
 five business days

PAGE 144

original

Definite termination date

No notice

Three-day

protects the public

PAGE 145

18 years old

PAGE 146

prior to

24 hours

pass the state portion

national portion

PAGE 147

continuing education requirements

32 days

inactive

all

errors and omissions (E&O) insurance

PAGE 148

brokerage firm

no height or size requirements

Advertisements

PAGE 149

written

request in writing

disciplinary action

damages

damages

PAGE 150

over disputes

competent

education

PAGE 151

definite termination date

mandatory rental pool

options

PAGE 152

an appraiser

## UNIT 1: LECTURE OUTLINE

### I. TRUST ACCOUNTS

#### B. Establishing Brokerage Accounts

1. Brokerage firms typically have two types of accounts:
  - a) Operations, used for running the firm
  - b) Trust accounts, used to hold money for the benefit of others
4. Employees or broker-associates are not permitted to have trust accounts.
6. Principal brokers who have trust accounts must follow specific rules. The principal broker
  - a) must use a high level of accuracy and care;
  - b) is personally responsible for the funds in the trust account;
  - c) is subject to commission audit at any time; and
  - d) should establish the trust account prior to receiving money belonging to others.

#### C. Operating a Trust Account

3. The trust account may not contain operating funds or any funds belonging to employed broker-associates.
  - a) Employed brokers' commissions are paid from the broker's operations account.
4. Care must be taken to not commingle the broker's funds with trust funds.
  - a) The account may contain sufficient brokerage funds to open and operate the account.
  - b) Commissions or other funds that have been earned and belong to the broker must be removed from trust account promptly.

#### D. How Many Trust Accounts Does a Broker Need?

1. A broker needs enough trust accounts to assure that funds will not be commingled.
2. The Commission requires the following types of separate accounts when the broker is holding funds for others:
  - a) Sales trust account—for money held in connection with sales transactions pending closing, which is also known as earnest money
  - b) Management trust account—for money held in connection with property management services
  - c) Security deposit trust account—for refundable security deposits collected from tenants for lease and rental units under management by the broker

#### E. Requirements for a Trust Account

1. Trust accounts must be in a bank or appropriate institution located in Colorado.
2. They must be insured by a government agency, such as the FDIC.

3. Trust accounts cannot be held in a credit union because only members' funds are insured.
4. Trust accounts must follow specific requirements of the Commission.
  - a) The brokerage firm name and principal broker's personal name must be on account records.
5. The bank must recognize that the account is a trust account.
  - a) Checks and deposit slips must indicate that it is a trust account.

#### F. Interest-Bearing Trust Accounts

1. The parties must agree if the account is to be interest bearing.
  - a) Details of interest, fees, penalties, and disposition of interest are negotiated and written into the contract.
  - b) These funds are placed in a trust account separate from all other funds held by the broker.
2. Exception
  - a) The broker's sales trust account may be an interest-bearing account if the interest benefits an affordable housing program.

## II. EARNEST MONEY

### A. Earnest Money Deposits

1. Earnest money deposits are typically payable to the listing brokerage firm and presented with the contract offer.
2. The type of the earnest money (such as check or promissory note) is identified in the Contract to Buy and Sell.
  - a) Earnest money is anything the seller will accept.
3. Checks must be deposited not later than the third business day following notice of acceptance of the offer.
4. Earnest money can be held in the trust account of a third party, such as a title company, with the permission of the parties.
5. The holder of the earnest money is identified in the contract and is often shown in the MLS. Listing brokers must advise buyer's brokers if the earnest money is to be held by a third party.
6. If a contract terminates under a provision of the contract or ends due to an undisputed default of either party, the broker is required to disburse the funds to the proper party without delay.

### B. Earnest Money Promissory Note

1. A note is a reasonable alternative when the buyer has limited funds available when the offer is submitted.
2. Notes are made payable to the listing brokerage and must be identified with the due date specified in the Contract to Buy and Sell.
3. The due date must be before closing in time for the funds to be good funds at closing.



4. If the note cannot be collected when due, the listing broker must inform the seller immediately and is responsible for the collection of the funds.
- a) The seller can choose to declare the contract in default or agree to extend the contract.

### III. RECORDKEEPING

#### A. Records and Recordkeeping Systems

1. Principal brokers must have trust account records that include the following:
  - a) Account journal of all cash receipts/disbursements—a chronological record of all activity in the account
  - b) Beneficiary ledger account system—records with specific details regarding the parties for each transaction
  - c) Broker ledger card—for funds belonging to the brokerage firm
  - d) Bank reconciliation records
- (1) Trust accounts must be reconciled every month that there is activity in the account.
2. The transaction file will include all support documents for any funds held in the trust account. At minimum, these records include copies of the following documents:
  - a) Contract, earnest money check, Seller's Property Disclosure, listing or buyer representation agreement
  - b) Copies of the closing statements and other closing documents signed at closing for the parties they represented
3. Employing brokers are responsible for making sure that they have a complete file of all required documents and agreements made during the transaction.
  - a) Employed brokers are required to return files to the employing broker for review and filing immediately after the closing.
4. Brokers must maintain required records for a minimum of four years.
5. The listing broker must have the exclusive right-to-sell listing contract in its file and the buyer's broker agreement or brokerage disclosure must be in the selling brokerage firm's file.

#### B. Safeguards

1. Frequent reconciliation

#### C. Commingling/Conversion of Trust Account Funds

1. Commingling is the improper mixing of operating account funds with trust account funds.
  - a) Not removing earned commissions or fees from the trust account promptly is an example of commingling.
2. The illegal practice of conversion is the use of one party's funds for the benefit of another party.
  - a) Paying bills for a property owner whose ledger card does not have sufficient funds, even though the check will clear the bank, is an example of this.

3. An owner's ledger card can have a zero balance at times—this is not commingling or conversion. However, a negative balance for an owner is most likely an example of conversion.

#### D. Property Management

##### 1. Accounts

- a) The management account holds funds belonging to the property owners and it is used to manage the property.
- b) Security deposits must be held in an account separate from the owner's account because the funds belong to the tenants.
- c) Property management-related rents must be deposited into the appropriate trust account not later than five business days following receipt of the money.
- d) Principal brokers who hold earnest money and manage properties must have the following:
  - (1) A sales trust account to hold earnest money
  - (2) At least one property management account for owners' funds
  - (3) At least one security deposit trust account for tenants' funds
  - (4) A broker can have an unlimited number of deposits for each type of funds in the above accounts—separate accounting using the ledger card identifies the individual transactions and properties.

##### 2. Security deposits

- b) The broker can turn the deposit over to the owner
    - (1) with written authorization of the tenant;
    - (2) if the lease calls for it; or
    - (3) after notifying the tenant in writing that the owner is holding the deposit.
  - c) The broker is responsible for security deposits and must notify tenants if no longer managing the property and advise tenants how to contact the new manager.
  - d) The security deposit must be returned in full or an accounting of the reason the deposit was kept must be sent to the tenant within one month or within 60 days if the lease calls for it.
5. Homeowners association records belong to the association, not the brokerage firm. All such records must be promptly returned to the association upon termination of the broker's employment. A broker may retain file copies at the broker's own expense.

#### IV. CLOSING FUNDS

A. Good funds must be available for closing.

B. Clients must bring their funds in good funds.

- 1. A check made payable to the client is recommended.

## V. CONFIDENTIAL INFORMATION

- A. Clients' confidential information, such as motivating factors or the willingness to consider different price or terms, must be filed so as to protect the client's information.
  - 1. Confidential information must be protected from other brokers within the firm.
  - 2. Designated brokerage eliminates imputed knowledge within the firm; other brokers are not presumed to have access to confidential information.

## UNIT 1: GLOSSARY REVIEW

- 1. An amount charged to a party to pay a bill is a debit.
- 2. The place where a broker holds money that belongs to other parties is a trust account.
- 3. An amount of \$0.01 per \$100 charged when a deed is recorded is called the documentary fee.
- 4. The document from the county treasurer that summarizes the current status of taxes is the certificate of taxes due.
- 5. An amount received by a party to pay a bill is a credit.
- 6. The final settlement created by the terms of the Contract to Buy and Sell is called closing.
- 7. Recording a document creates constructive notice of the contents of the document.
- 8. A CREDIT to the broker is used to pay a bill.
- 9. Dividing expenses between the buyer and seller based on ownership periods is called proration.
- 10. A place where a lender holds borrower's funds to pay bills at a later time is a lender reserve/impound account.
- 11. A summary of the financial part of a closing for one party to the transaction is a closing statement.
- 12. DEBITS and CREDITS are always in equal amounts.

## UNIT 1: LECTURE OUTLINE

### I. HOW THE CLOSING IS CREATED:

- A. The closing is created by the Contract to Buy and Sell along with other supporting documents, such as the closing instructions, tax certificates, and the title commitment.
- B. There are four parties, each with separate obligations that are involved in the closing process:
  - 1. The seller, who is obligated to clear all liens on the property that are not being assumed by the buyer.
  - 2. The buyer, who is obligated to meet all the requirements of the contract and bring good funds to closing.

3. The brokers, who are obligated to verify the party they represent is meeting the obligations of the contract. The broker is also responsible for the for the party he has been.
- a) Brokers are also responsible for the closing statement for the party they have been designated to represent.
4. The closing company hired by the buyer and seller in the closing instructions is obligated to complete the forms per these instructions.

C. The four most typical ways to close a real estate purchase are by using the following:

1. Cash, which is covered in this unit
2. Assumable loans, in which the buyer takes over the seller's existing loan
3. Seller-carry loans, often used with an assumable loan, which is covered in Unit 2
4. New loans, which are covered in Unit 3

E. Responsibility for the proper accounting at a closing:

1. Overall responsibility belongs to the listing brokerage and listing broker.
2. Individual licensee responsibility: The designated brokers are responsible for the accuracy of the closing statement.
  - a) The designated listing broker is responsible for the closing statement for the seller.
  - b) The designated buyer's broker is responsible for the closing statement for the buyer.
3. Brokers are expected to attend the closing. If a designated broker is unable to attend, the employing broker may appoint another broker to attend.
  - a) In this instance, all three brokers, employing broker, original broker, and appointed broker, will be responsible for the accuracy of the closing statement for the party represented.

F. Closing Company or Other Closing Entity

- b) Engages the closing company and outlines requirements for closing

## II. BUYER'S AND SELLER'S COLUMNS

A. DEBIT, item owed (disadvantage), means one of the following:

1. A charge to either the buyer or seller on the day of closing, or
2. If the DEBIT is to the seller, it reduces the amount of cash the seller will take away from closing.

B. Examples of seller DEBITS (items owed):

(Items that reduce the amount of cash the seller receives at closing)

2. Property taxes for the preceding year; seller will owe the full amount
5. Proration of rents collected for the month of closing; seller will always owe the buyer a prorated share

C. Examples of buyer DEBITS (items owed):

(Items that increase the amount of cash the buyer must bring to closing)

1. Selling price of the property

E. CREDIT: money received (advantage) means the following:

1. A benefit to the buyer or seller (something they receive at closing)

2. A reduction in the amount of cash the buyer must bring to closing

G. Examples of buyer CREDITS:

(Items that reduce the amount of cash the buyer must bring to closing)

1. Earnest money already deposited by the buyer and held by the broker or closing company

### III. COMPLETING A SIX-COLUMN WORKSHEET

**Line 1. Selling Price:** Money the buyer owes the seller. Used in all closings.

Always DEBIT buyer, CREDIT seller (DB CS).

**Line 2. Deposit, Paid to: (Broker):** The buyer's earnest money deposit, which is owed to the buyer at closing.

Always CREDIT buyer, DEBIT broker (CB DBk).

**Line 3. Trust Deed, Payable to:** The name of the lender for the assumable loan or new loan is listed here. In an assumption, the buyer is assuming this obligation of the seller, so this amount represents money the seller will not receive at the closing table. In a new loan, this amount is a single entry credit to the buyer.

Assumption: always DEBIT seller, CREDIT buyer (DS CB) the amount from the assumption statement.

**Line 6. Interest on Loan Assumed:** The seller will owe the buyer interest for the portion of the month the seller lives in the property.

Always DEBIT seller, CREDIT buyer (DS CB) the prorated share.

**Line 7. Owner's Title Insurance Premium:** The owner's title policy is paid by the seller, per the terms of the Contract to Buy and Sell, and will only show on the seller's closing statement.

DEBIT seller, CREDIT broker (DS CBk) who will pay the bill.

**Line 7a. Extended Title Insurance:** This additional coverage is negotiable per the terms of the contract. DEBIT seller or buyer per the contract and CREDIT broker, who pays the bill.

**Line 8. Closing Fee:** This is the fee charged by the title company to close the transaction and is negotiable per the contract; it may be paid by the seller or buyer, or split between the parties.

DEBIT seller and/or buyer per the terms of the contract. CREDIT the broker the full amount to pay the bill.

**Line 9. Notary Fee:** This fee is charged to the party that is signing the document.

DEBIT seller for the warranty deed and CREDIT broker.

DEBIT buyer for the deed of trust and CREDIT broker.

**Line 11. Recording: Warranty Deed:** Benefits the buyer by providing constructive notice of the buyer's new ownership of the property.

DEBIT buyer, CREDIT broker (DB CBk).

**Line 15. Documentary Fee:** A buyer's expense, paid at the time of recording the warranty deed. It is calculated by moving the decimal point four places to the left in the selling price.

**Remember:** = \$0.01 per \$100.

DEBIT buyer, CREDIT broker (DB CBk).

**Line 16. Certificate of Taxes Due:** The certificate that is obtained from the county treasurer and confirms the current status of governmental taxes on the property.

DEBIT buyer, CREDIT broker (DB CBk).

**Line 17. Taxes for Preceding Year(s):** If the taxes from the preceding year are unpaid, they are an obligation of the seller.

Always DEBIT seller, CREDIT broker (DB CBk) to pay the bill to clear the lien.

**Line 18. Taxes for Current Year:** Will be a proration between the seller and the buyer. Since Colorado property taxes are paid in arrears, the seller will owe the buyer.

DEBIT seller, CREDIT buyer the prorated share.

**Line 20. Special Taxes/Assessments:** This line refers to government special assessments. **The rule:** If listed in the contract, the seller will pay in full at closing. If the buyer is to assume the bill, there is *no* deduction at closing.

DEBIT seller, CREDIT broker (DB CBk).

**Line 21. Personal Property Taxes:** Typically a buyer responsibility.

DEBIT buyer, CREDIT broker.

**Line 32. Water and/or Sewer:** The water/sewer bill can be paid in advance or arrears. It will be prorated between the seller and buyer. Determine how to prorate based upon the information given.

Prorated between the parties. If a bill is owed, CREDIT broker.

**Line 33. Rents:** The seller collects the rent from the tenant in advance for the month. The seller will always owe the buyer for the buyer's prorated share.

DEBIT seller, CREDIT buyer the prorated share.

**Line 34. Security Deposits:** The seller is holding the tenant's security deposit and it must be transferred in full to the new buyer.

Always DEBIT seller, CREDIT buyer full amount.

**Line 37. Broker's Fee:** This fee is typically paid by the seller.

DEBIT seller, CREDIT broker (DS CBk).

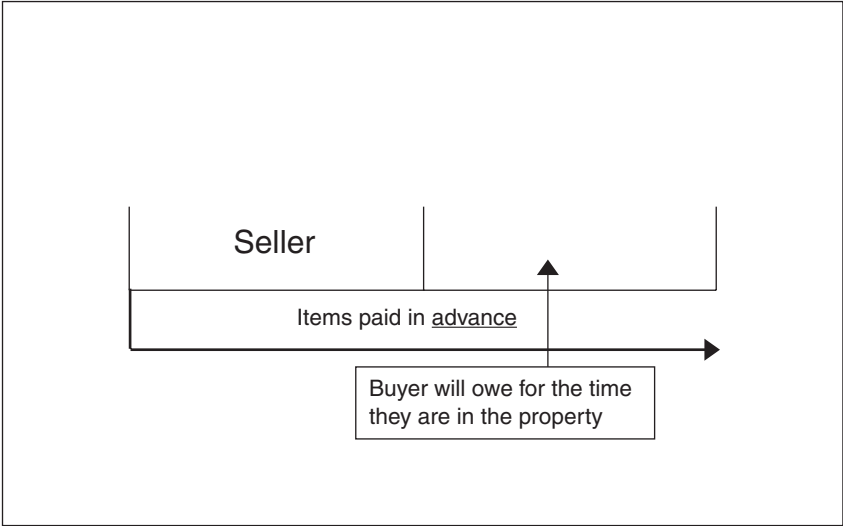
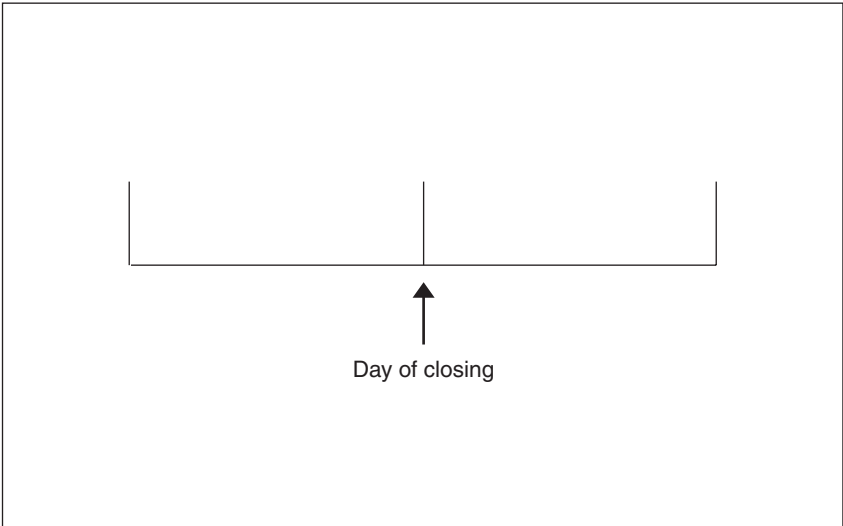
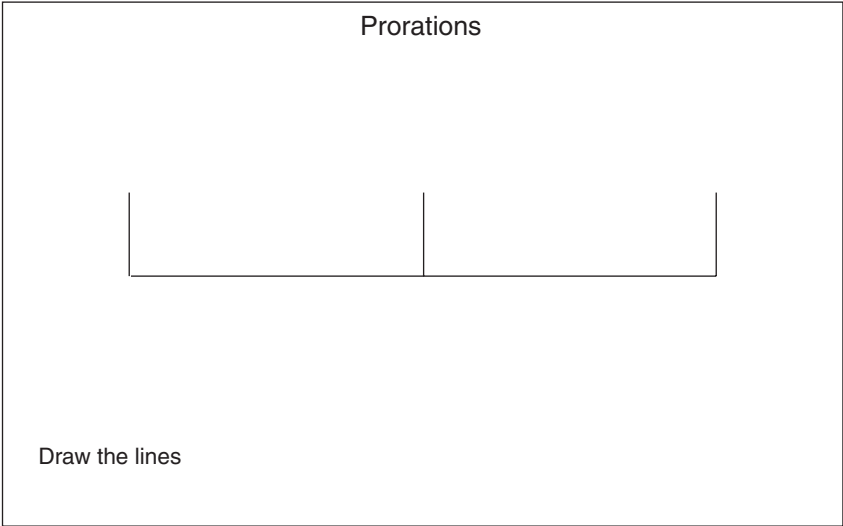
**Line 39. Net Loan Proceeds:** When a new loan is used, the broker will receive a DEBIT in this amount.

DEBIT broker (single entry).

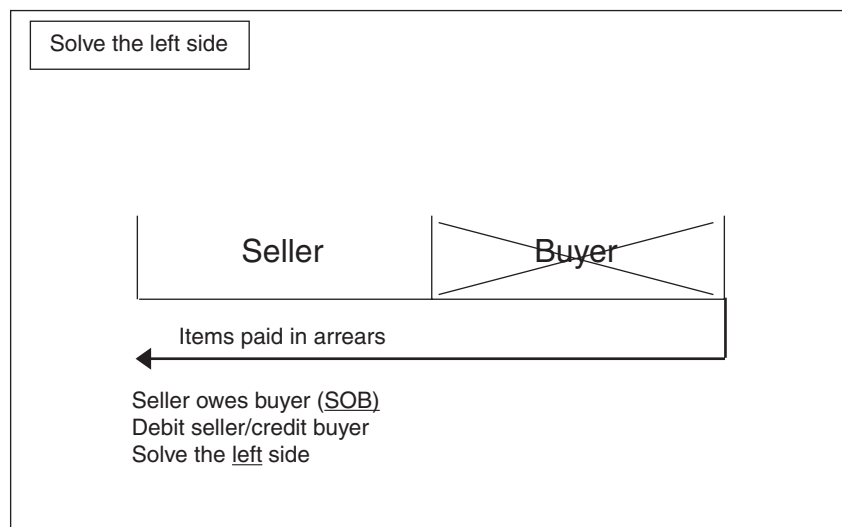
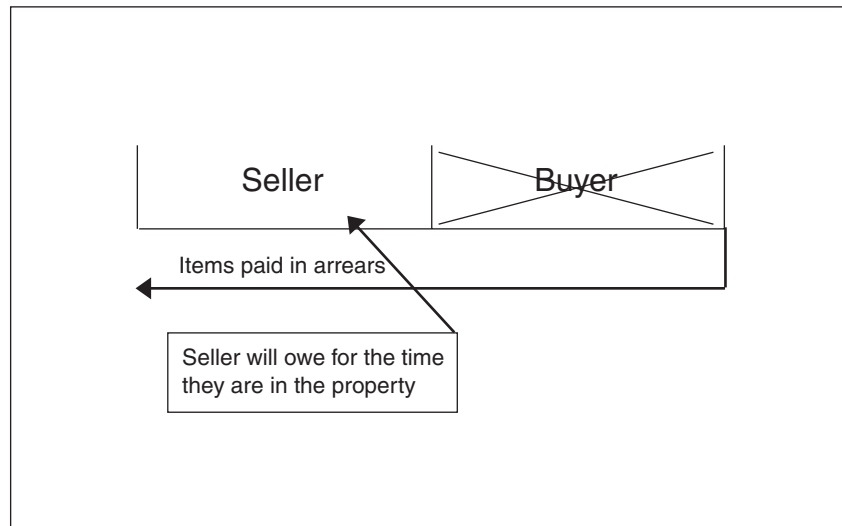
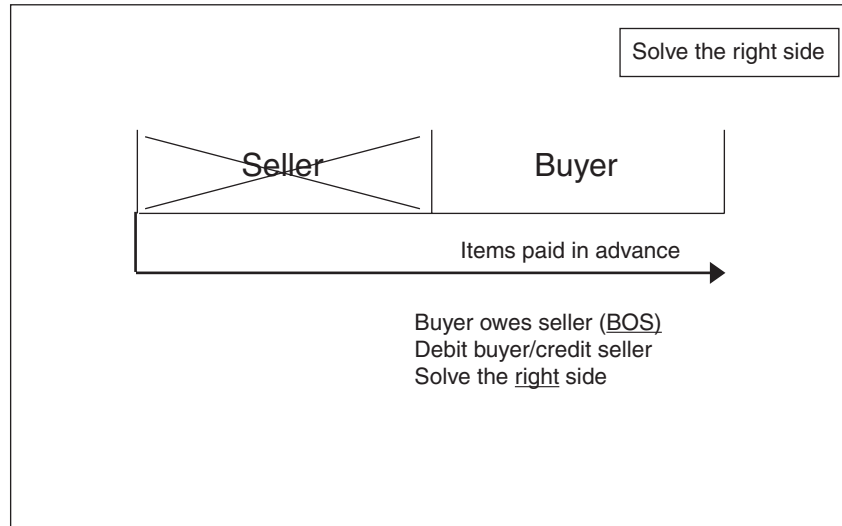
#### IV. PRORATIONS

1. Buyer owns on day of closing.
2. Use 365 days in a year (366 for leap year).
  - a) Use calendar months—know how many days.
3. Never prorate the following:
  - a) Security deposits
  - b) Loan payment due for month of closing. (Because interest is paid in arrears, a loan payment due pays the month before closing. The seller will owe the full amount.)
  - c) Special taxes (special assessments)
    - (1) Contract says seller pays off special assessments.
    - (2) If both parties agree, could be assumed by the buyer and will not show up on the closing statement.

B. How to Prorate







Whenever you prorate, the calculation is always the same:

$$\text{total bill} \div \text{total days} \times \text{days owned} = \text{prorated \$}$$

In Colorado, we use a 365-day year and the actual days in the month. February has 28 days, unless it is a leap year, not 30. For either test, follow the directions given in the exam.

	National Test	State Test
Who owns the day of closing?	<u>Seller</u>	<u>Buyer</u>
How many days in the month?	<u>30 in every month</u>	<u>Actual</u>
How many days in the year?	<u>360</u>	<u>365 or 366 (leap)</u>

#### D. Proration Example 1:

##### Step 6:

Calculate one party's share. In this case, taxes are paid in arrears, so the seller owes the buyer for the seller's 102 days of ownership prior to the closing. The formula is always the same: total bill ÷ total days × days owned.

**Tip:** Use your calculator for the calculation and don't write down the daily amount to re-enter later. Most calculators easily retain the six decimal places needed to ensure an accurate calculation.

$$\$1,366 \div 365 \times 102 \text{ days} = \$381.73$$

DEBIT seller, CREDIT buyer

## UNIT 2: GLOSSARY REVIEW

1. The document from the county treasurer reporting the current status of taxes due on a property is the certificate of taxes due.
2. A loan from the seller to the buyer to help finance the sale is referred to as seller-carry financing.
3. The fee paid to have the signature on a document witnessed and affirmed is the notary fee.
4. A loan guaranteed by a government agency is a VA loan.
5. A lender may hold borrower's funds to pay future bills such as taxes and insurance in lender reserve/impound accounts.
6. The exact amount of the assumption balance reported by the existing lender is a CREDIT to the buyer at closing.
7. Hazard insurance protects the owner from fire and other casualty losses.
8. Special taxes/assessments or localized improvements by the government will normally be paid off by the seller at closing.
9. A CREDIT in the broker's column typically represents a DEBIT from a buyer or seller.
10. When a buyer takes over responsibility for the seller's loan to help pay the purchase price of a property, this type of closing is called a loan assumption closing.

## UNIT 2: LECTURE OUTLINE

### I. ASSUMPTION AND SELLER-CARRY LOANS

- Mortgage interest is paid in arrears.
- Payments are made on the first of the month (unless otherwise stated).

#### A. Assumption Statement

#### 3. Assumed Loans (Line 3. Deed of Trust, Payable to)

The amount for the loan being assumed will always:

- a) be a seller DEBIT because this is a loan that is owed and will not be part of the funds the seller will receive for the sale;
- b) be a buyer CREDIT because the buyer is taking over the loan and will not have to bring these funds to closing to pay for the property; and
- c) appear on both closing statements.

- 4. When a loan is being assumed, expect to see a proration of interest for the month of closing. The seller will owe the buyer for the time the seller owns the property.

#### B. Prorating Interest on an Assumed Loan (Line 6. Interest on Loan Assumed)

- 2. For the proration of an assumed loan to be correct, it **MUST** be calculated using monthly interest.
- 3. **Special rule:** Assumed interest is always annual interest divided by 12.
- 4. Always DEBIT seller and CREDIT buyer.
- 5. The amount for any loan payment due will always be

- a) seller DEBIT, and
- b) broker CREDIT to pay the bill

- 6. Never prorate a loan payment that is due.

#### C. Lender Reserves (Lines 19. Tax Reserve and 24. Hazard Insurance)

- 1. Lender reserves for taxes and insurance to set up new impound accounts are *always* a buyer DEBIT.

#### D. Notary Fees (Line 9)

- 1. Notary fees are always paid by the party that signs the document.
- a) The warranty deed is signed by the seller.
- b) The cost of any associated notary fee is a DEBIT to the seller; CREDIT the broker.
- c) A deed of trust is signed by the buyer.
- d) The cost of any associated notary fee is a DEBIT to the buyer; CREDIT the broker.

E. Insurance (Line 23. Premium for New Insurance)

1. Hazard insurance is paid for a policy year that starts the month of closing.

F. Rental Properties (Line 33. Rents and Line 34. Security Deposits)

1. Rent payments are collected on the first of the month in advance from the tenant.

2. The seller will always owe the buyer rent from closing to the end of the month.

a) Rent is always:

seller DEBIT prorated share, and

buyer CREDIT prorated share.

3. A security deposit is the tenant's money.

a) It must be transferred in full to the buyer/new owner.

b) Always debit the seller and credit the buyer the entire amount.

G. Prorating Rent

1. Rent is income and not a bill, so it is handled differently than the proration rules about advance and arrears, which apply only to transfers between the seller and buyer.

2. Rent is collected in advance by the seller from the tenant. This means the seller will *always* owe the buyer for the buyer's portion of the month.

H. Seller-Carry Loans (Line 4. Deed of Trust, Payable to: seller)

2. The amount of new seller-carry loan will always be these:

a) DEBIT to the seller because the seller will not receive this amount in cash at closing. Instead, the seller agrees to accept the buyer's note and secure it with a deed of trust in this amount.

b) CREDIT to the buyer because the buyer does not bring this amount to closing in cash. The buyer signs the note and secures the debt with a deed of trust creating a lien on the property (usually in second position to an existing loan).

I. Calculating Interest Adjustment on a Seller-Carry Loan or New Loan: (Line 29. Interest on New Loan)

a) For the calculation of a seller-carry to be correct it *must* be calculated using daily interest (annual interest divided by 365).

b) Interest on seller-carry or new loans is divided by 365.

## II. BUYER AND SELLER TRANSFERS

A. Buyer and seller transfers occur when money is transferred on paper at closing between the two parties to the transaction (the buyer and the seller). Common buyer and seller transfers include the following:

1. Sales price: always CREDIT seller, DEBIT buyer
2. Loans in an assumption
  - a) The loan being assumed
  - b) A seller-carry second loan
  - c) Always DEBIT seller, CREDIT buyer
3. Prorations
  - a) Interest on a loan assumed: SOB (solve left side and divide annual interest by 12)
  - b) Taxes for the current year: SOB (solve left side)
  - c) Water and/or sewer flat rate bills—arrearages or advance per the contract
  - d) Interest on a new seller-carry loan: BOS (solve right side)
  - e) Rents: always seller owes buyer. (**Remember:** Security deposits are not prorated but will be transferred in full.)
4. Calculation of interest on new loans
  - a) Interest on a new seller-carry loan (divide annual interest by 365)

## III. SELLER SETTLEMENT ITEMS

A. Seller settlement items are CREDITS or DEBITS that will show on the seller's closing statement and typically not on the buyer's closing statement.

1.	Selling Price	Seller <u>CREDIT</u>
5.	Deed of Trust Payoff	Seller <u>DEBIT</u>
6.	Interest on Loan Assumed—prorate what seller owes	Seller <u>DEBIT</u>
7.	Owner's Title Insurance	Seller <u>DEBIT</u>
8.	Closing Fee	Seller <u>DEBIT</u>
9.	Notary Fee	Seller <u>DEBIT</u>
13.	Recording; Release	Seller <u>DEBIT</u>
17.	Unpaid Taxes for the Preceding Year	Seller <u>DEBIT</u>
18.	Taxes for Current Year—prorate what the seller owes	Seller <u>DEBIT</u>
34.	Security Deposit	Seller <u>DEBIT</u>
36.	Loan Payment Due	Seller <u>DEBIT</u>
37.	Broker's Fee	Seller <u>DEBIT</u>
38.	Seller's Attorney	Seller <u>DEBIT</u>

#### IV. BUYER SETTLEMENT ITEMS

A. Buyer settlement items are **CREDITS** or **DEBITS** that will show on the buyer's closing statement and not on the seller's closing statement.

1.	Selling Price	Buyer <u>DEBIT</u>
2.	Earnest Money Deposits:	Buyer <u>CREDIT</u>
8.	Closing Fee	Buyer <u>DEBIT</u>
9.	Notary Fee	Buyer <u>DEBIT</u>
10.	Buyer's Attorney	Buyer <u>DEBIT</u>
11.	Recording: Warranty Deed	Buyer <u>DEBIT</u>
12.	Recording: Deed of Trust	Buyer <u>DEBIT</u>
15.	Documentary Fee	Buyer <u>DEBIT</u>
16.	Tax Certificate	Buyer <u>DEBIT</u>
	Loan Costs	
7b.	Mortgagee's Title Insurance	Buyer <u>DEBIT</u>
27.	Loan Origination Fee	Buyer <u>DEBIT</u>
28.	Loan Discount Points	Buyer <u>DEBIT</u>
29.	Interest on New Loan—prorate the amount owed for the month	Buyer <u>DEBIT</u>
35.	Loan Transfer Fee	Buyer <u>DEBIT</u>
30.	Survey	Buyer <u>DEBIT</u> unless otherwise negotiated in the contract
31.	Appraisal	Buyer <u>DEBIT</u> unless otherwise negotiated in the contract

2. Which buyer items are negotiable per the Contract to Buy and Sell?

- a) Appraisal fee
- b) Survey
- c) Closing fees

**Remember:** ASC (ASK) what was negotiated.

#### V. LOAN ASSUMPTION WORKSHEET

A. The lender provides a summary of the loan balance and other loan details to allow the broker to close the transaction.

2. The assumption loan balance is a DEBIT to the seller and a CREDIT to the buyer.

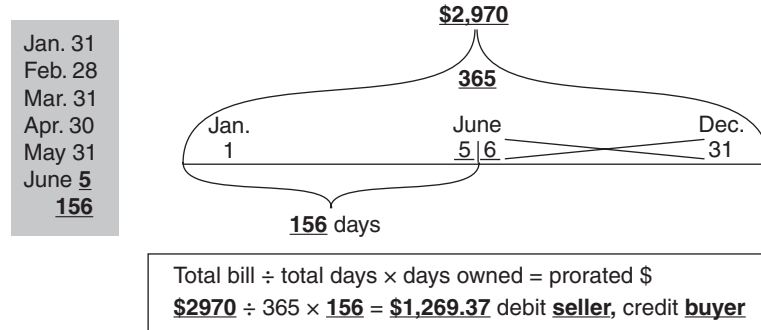
B. The broker uses information from many sources, which may include the following:

1. The Contract to Buy and Sell

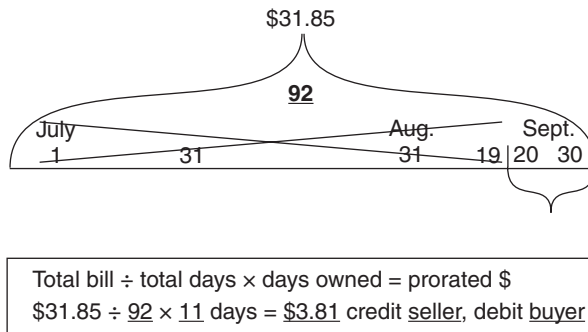
C. The six-column worksheet summarizes the financial transactions at the closing table and creates the information used to generate the closing statement for the buyer and seller.

## VI. PRORATION PRACTICE

**Line 18. Current Year Taxes:** Taxes for the preceding year were \$2,970. For a June 6 closing, what will be the prorated share?



**Line 32. Water and/or Sewer:** A water bill of \$31.85 was paid in advance for the months of July through September. If the closing is September 20, what will the prorated entry be?



## UNIT 3: GLOSSARY REVIEW

1. The document recorded to indicate that a lien has been paid off is a release of the deed of trust.
2. A document that creates a lien and has the highest priority is a first deed of trust.
3. The administrative fee charged by a lender to set up a loan is the loan origination fee.
4. To protect against defects in title, a lender will usually require the buyer to purchase a mortgagee's title insurance policy.
5. Fees usually quoted as a percentage of the loan amount and used to increase the lender's yield, acquire a lower interest rate for the buyer, or both, are known as loan discount points.
6. A loan that is neither guaranteed nor insured by a government agency is called a conventional loan.
7. A loan created with a lower lien priority, such as a seller-carry loan, is often a second deed of trust.
8. A conventional loan with a loan-to-value ratio greater than 80% will typically require private mortgage insurance (PMI).

9. An assumption close uses double entries, while a new loan close is mostly single entry.
10. The designated broker is responsible for the closing statement for the party represented.

## UNIT 3: LECTURE OUTLINE

### I. REVIEW OF THE SIX-COLUMN REAL ESTATE SETTLEMENT WORKSHEET

#### A. Types of closing entries

There are four main types of entries on the settlement worksheet:

1. Seller and buyer exchanges of funds
  - a) Examples are prorations and the selling price.
2. Funds held by the broker until the closing
  - a) The most common example is earnest money.
  - b) This is a CREDIT to the buyer and DEBIT to the broker (deposit into escrow account), offsetting DEBIT and CREDITS.
3. Bills paid by the broker on behalf of the seller or buyer
  - a) Examples: attorney's fee or recording fees
  - b) DEBIT to the responsible party for the item, and CREDIT to the broker (out of the escrow account) for writing the check

### II. THE SIX-COLUMN CLOSING WORKSHEET—SUMMARIZING THE TRANSACTION

#### A. The six-column closing worksheet summarizes the transaction with DEBIT and CREDIT columns for the following parties:

1. Seller
2. Buyer
3. Broker

#### B. Items unique to the six-column worksheet

2. Only the closing worksheet shows items going in and out of the broker/closer escrow account.

#### C. Loan assumption

1. Buyer assumes and agrees to pay the remaining balance on a seller's existing loan. Uses double entries.

#### D. New loan

1. When the buyer gets a new loan, the new lender will withhold funds from the gross loan amount to pay some of the expenses of closing. Uses mostly single entries.



### III. OTHER FORMS USED AT CLOSING

#### A. Seller or buyer closing statement

2. This form or a suitable substitute is mandatory when the broker conducts the closing.
3. Shows all of the DEBITS and CREDITS for the seller or buyer.
4. Must be maintained in employing broker's files for four years.
5. The designated listing broker checks figures for the seller.
6. The designated buyer's broker checks figures for the buyer.

#### B. Real Property Transfer Declaration (TD-1000)

1. Helps ensure fair and uniform assessments of property taxes

### IV. GOOD FUNDS AT CLOSING

#### A. Good funds are

1. a cashier's check,
2. a teller's check from a savings and loan, or
3. a wire transfer.

#### C. Promissory note for earnest money

1. Must be honored in time to clear and be good funds by closing.

### V. ERRORS AT CLOSING

#### A. Found before closing

1. Have the closing company correct the error.

#### B. Minor error found at closing

1. Parties may agree to adjust the error or delay closing (typically with a small check or cash).

### VI. NONRESIDENT SELLER WITHHOLDING

#### B. The seller is subject to withholding tax if

1. the seller lives outside of Colorado; and
2. the sales price is greater than \$100,000.

#### D. The amount of tax withheld will be the lower of

1. Two percent of the sales price; or
2. the seller's entire net proceeds (balance due to the seller).

#### E. It is the responsibility of the closing entity to collect the withholding tax:

1. The closing company can be an attorney, a broker, or the closing/title company.
2. The closing entity is responsible for immediately forwarding the funds to the Colorado Department of Revenue.

## VII. NEW LOAN CLOSINGS AND THE NEW LOAN STATEMENT

A. A new loan statement provides the broker the following information:

1. The amount of the loan
2. Specific bills the lender will withhold from the loan
3. Net amount of the check the lender will provide to fund the rest of the closing

B. Use lender figures exactly as provided.

C. In a new loan, the lender brings the majority of the money for the buyer.

1. The new loan statement will show three sets of numbers the closer/broker needs:

a) Gross or total new loan amount (line 3)

b) Lender payouts

c) Net loan proceeds (line 39)

2. The buyer will always have a large CREDIT called the *gross loan amount*.

3. From this amount, the lender will pay the majority of the bills, which are then totaled in the lender payouts.

4. The difference between the gross loan amount and the lender payouts is the net loan proceeds, which will be a DEBIT (deposit) into the closer/broker column so the final checks can be written.

5. The new lender provides a new loan statement with information about financing and items the lender is paying from the gross loan amount.

6. The lender also provides a net loan proceeds number that represents what remains of the gross loan amount after the lender pays the bills listed in the new loan statement.

7. All of these numbers from the new loan statement are single entries on the six-column settlement worksheet.

8. The broker records the lender single entry numbers on the closing worksheet first.

9. The closing entries not related to the new loan are all double entries and result in balanced lines with equal dollar values of DEBITS and CREDITS.

D. Items unique to a new loan closing

1. The gross amount of the new loan on line 3 is a buyer CREDIT single entry.

2. A loan payoff on line 5 to clear the seller's previous loan is a seller DEBIT single entry.

3. Various expenses paid by the lender on behalf of both the seller and the buyer are single entry DEBITS to the party responsible for that obligation.

4. The net loan proceeds from the lender's new loan statement is a single entry DEBIT to the broker. It is deposited into the escrow account and used to fund the closing.

E. Items unique to the new loan statement

Items will be assigned as follows on a new loan statement:

Line	Item	To the Buyer	When
3	New loan amount	<u>Credit</u>	Always
7a.	Mortgagee policy	<u>Debit</u>	Always
31	Appraisal	<u>Debit</u>	Unless otherwise stated in the contract
27	Loan origination fee	<u>Debit</u>	Unless otherwise stated in the contract
28	Discount points	<u>Debit</u>	Unless otherwise stated in the contract
29	Interest on new loan	<u>Debit</u>	If first payment more than one month after closing
	<b>Item</b>	<b>To the Seller</b>	<b>When</b>
5	Prior loan payoff	<u>Debit</u>	Always
13	Release of deed of trust	<u>Debit</u>	Always

## APPENDIX, UNIT 1: LECTURE OUTLINE

### I. COMPETENCY

#### A. Competency levels

- Are you experienced, trained, and qualified to do what you've been asked to do?
- As a future broker-associate, you need to be aware that your competency level at this point is very low.
- Specialties and competency requirements:
  - Commercial real estate is highly specialized and requires additional training.
  - Property management can involve commercial and residential properties.
  - Property management frequently requires an employing broker's license.
  - Farm and ranch can involve water rights and/or mineral rights.
- Because there are no standards for competency, it is the broker's responsibility to determine your areas of competence.
- Ask yourself the following questions:
  - Have I had enough training for this type of transaction?

#### B. How to gain competency

- Education and training
  - Your company training
  - Local REALTOR® association trainings
  - Continuing education classes

## II. PROPERTY MANAGEMENT

### A. Types of property management

1. Residential property management
2. Commercial property management

### B. Leasing versus property management

1. First, it is necessary to determine the difference between leasing and property management.
2. Leasing is a onetime activity in which a licensee (broker-associate) works with a seller/owner to find a tenant for the property.
3. Property management is an ongoing relationship with a property owner to manage a property, including the responsibility for leasing it.
  - a) This relationship would require a property management agreement signed by your employing broker.

### C. Property management agreement

1. The property management agreement is between the property owner and the brokerage firm and includes the following:
  - b) Duties of the firm and the property owner
    - i) (1) Maintenance
    - ii) (2) Utilities
    - iii) (3) Collection of rent
    - iv) (4) Security deposit

### D. Trust accounts

1. Trust accounts are required for security deposits and rents.
  - a) Remember that only employing brokers can have trust accounts and they must be in the name of the brokerage firm.

### E. Broker-associates

1. According to the Commission Update, "Broker-associates may not manage any property without the knowledge, consent, and supervision of their employing broker."
  - b. This means that broker-associates may not
    - (1) negotiate a lease without an agreement or
    - (2) help a friend out by offering to advertise, lease a property, or hold funds.

## III. ENTERING THE FIELD

### A. Employment agreement

1. You will most likely be working as an independent contractor, not an employee.
2. Independent contractors sign an independent contractor agreement (ICA) when they are hired.

3. The ICA provides the details of your independent contractor status, including the following:

- a) You will receive a 1099 form instead of a W-2 form.
- b) You are responsible for paying your own taxes and setting your own schedule.

5. Remember, you are starting your own business and with the aid of training will have the freedom to determine your own hours and work methods.

B. Steps to get an interview

4. Remember that you are making the selection, not the other way around.

C. Questions to ask brokers

- 1. Your book has a comprehensive list of questions to ask your brokers.
- 2. You will find it helpful to review all of these questions and write down some of your own before interviewing employing brokers.

3. In this section, we will review a few of the questions we think are important.

4. What training does the brokerage firm offer?

5. What does the firm pay for or provide for brokers?

7. What are the E&O insurance rates?

8. Must I join a local association of REALTORS®?

9. Costs to get started that a broker-associate typically will pay for include the following:

- a) Real estate license: \$485 (for three years)
- b) E&O insurance: \$300 (approximate annual cost)
- c) REALTOR® association dues: \$560 (approximate annual cost)

10. What other start-up costs might I be asked to pay for?

12. What are the ongoing monthly costs?

13. What are the commission splits?

E. What is your job description?

2. Know what to do when someone says “yes”.

a) Be prepared to give a credible presentation to buyers and sellers so they want to work with you.

c) Know who to go to when you need help.

2. Think systems

a) How much money do you want to make?

G. Prospecting and Marketing

1. Prospecting

b) Call everyone you know (sphere of influence) to ask if they or someone they know wants to buy or sell

f) Hold open houses for other brokers

## 2. Marketing

b) Email everyone you know about interesting real estate information or articles

## I. Presenting your product—*you!*

1. Most brokerage firms have prepared presentations you can customize to tell buyers and sellers what you and your company can offer them.

## J. Stay on the path to success

1. Get out of your comfort zone.

(1) Ask yourself the following questions:

a) Is this activity going to make me money?

## K. Typical workday

3. Contacts turn into leads and leads turn into appointments.

## IV. PROFESSIONAL EDUCATION

### A. Technical knowledge

1. Using the MLS system

3. Preparing listing/buyer contracts

### B. Product knowledge

1. Take a lot of classes

3. View many properties (schedule a preview rather than a showing)

### C. Professional designations

1. There are many designations, such as the following:

a) GRI: Graduate, REALTORS® Institute

b) CRS: Certified Residential Specialist

c) CPM: Certified Property Manager

d) CCIM: Certified Commercial Investment Member

e) SRES: Seniors Real Estate Specialist

f) NAR's GREEN designation or the EcoBroker designation: green and sustainable issues

g) SFR: Short Sales and Foreclosure Resource

h) CNE: Certified Negotiation Expert

## V. Current Trends

### A. Social media

2. Can be great tools if used properly

5. Don't give the appearance of personal use on social media sites when you are actually trying to gain a business advantage or information.

6. Receive client's permission before posting:

- a) Photos
- b) Virtual tour
- c) Open house locations

#### B. Marketing

1. Real estate continues to become high tech, but don't forget "high touch."

3. People like to do business with brokers they know and trust.

5. Often a call can move a client forward.

#### I. Offer to Closing

##### A. Working with buyers and sellers

3. Be sure to get help from your mentor, coach, or managing broker.

4. Education: Use your buyer/listing presentation to educate buyers and sellers and keep yourself on track.

5. Customer service: what will you do to provide top-quality service?

a) Think of things that will help you stand out with buyers and sellers. Write your ideas here:

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6. Helping buyers and sellers to succeed

b) Give sellers an accurate market analysis

##### B. Working with buyers

1. Meet with buyers to explain how you work and the process of buying a property (use your buyer presentation).

2. Determine your relationship with them (part of your buyer presentation).

4. Prequalify buyers to determine what they can afford.

a) You can request that this be done before your meeting.

##### D. Working with sellers

1. Do your homework (i.e., CMA, seller's net sheet) in advance so you are ready to make a great presentation and take the listing.

3. Arrive at the appointment on time and ready to show the sellers why they should list with you.

# ANSWERS TO CASE STUDIES

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## CURRENT LEGAL ISSUES

### Case Study #1

Both brokers were disciplined. The terms are not provided, but it can be assumed that the expedited settlement probably included some sort of restitution to the buyer.

- Clear case of incompetence with both brokers.
- Failure to disclose material facts regarding water flow.
- Listing broker was property manager so he cannot claim “no duty to independently investigate matters about the property”—he should have already known about them.
- “Well working” on the seller’s Property Disclosure isn’t necessarily a misleading statement—the seller might not have known about the flow rate.
- Failure to properly draft the terms of the contingency including not having a “quality” of water or flow rate requirement.
- Broker should have recommended that the buyers get their own well test instead of relying on a previous well test.
- Virtually nothing in writing between brokers from either side.
- No documentation of communications between selling broker and clients.
- Failure to exercise reasonable skill and care.

### Case Study #2

The disciplinary action taken in this case included the following:

- Public censure and class in contracts for the employed broker
- Public censure and class in brokerage administration for the employing broker
- Both brokers were jointly and severally liable for restitution in selling the property without commission earned.
- The Commission reviews “supervising” and employing broker roles as a part of all complaints.
- This was an inexperienced broker who required a “high level” of supervision including close monitoring of all transactions; the new broker was not properly supervised.

### Case Study #3

The broker’s license was revoked. In the criminal case, the broker was allowed to make full restitution and go on probation to avoid a possible 17-year prison sentence.

- Clear case of conversion of funds



## Case Study #4

Disciplinary action included:

- Broker Mary: Six-month suspension, public censure, and \$2,500 fine.
- Broker Paul: Agreed to voluntary surrender of license in lieu of suspension, censure, and fine
- What should have been done:
  - Disclose, disclose, disclose
  - Seller's Property Disclosure form asks about conditions that "now exist, or have ever existed."
  - Broker Mary may not have been held harmless by listing property with Broker Paul.
  - Both brokers had actual knowledge of the defects.
  - The seller, not Broker Paul, should have filled out the Seller Property Disclosure form.



# GLOSSARY

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**abstract** A summary of all documents affecting title to a property shown by the public records used to give an opinion of title. Less frequently used today than title insurance.

**accrued interest** The amount of interest that has accumulated since the last payment was made. For a Colorado closing on the 20th of the month, the seller would have accrued interest due for the first 19 days of the month. It is earned by the lender (accrued) but not payable until the next loan payment.

**adjustable-rate mortgage (ARM)** A loan that allows the borrower's interest rate to fluctuate based on some external index beyond the control of the lender.

**adjustments** The method used by brokers and appraisers to account for differences in comparable properties. If a subject property is superior, the appraiser makes a dollar adjustment increasing the sale price of the comparable. If the subject property is inferior to the comparable property, a negative adjustment is made.

**advance** *See* paid in advance

**after-tax cash flow** The amount remaining to an owner of income property after all expenses, debt service, and income taxes have been paid.

**agency** The relationship of agents and their principals.

**agent** A person who represents another person in a fiduciary relationship.

**ambiguity** A statement that is unclear or may have several meanings.

**annual mortgage constant** The factor that, if multiplied by the original loan balance, results in the annual mortgage payment; the mortgage payment's percentage of the original loan.

**annual percentage rate (APR)** An expression of credit costs over the life of a loan, taking into account the note interest rate plus lender fees for originating, processing, and closing a mortgage loan. The APR should be higher than the note rate.

**antitrust** Federal law that prohibits monopolistic practices such as price fixing.

**appraisal** An unbiased estimate of a property's market value.

**appraising** The process of estimating the market value of property.

**arm's-length transaction** A business transaction in which the parties are dealing in their own self-interest, not being under the control of the other party. One of the requirements before a comparable sale should be used in an appraisal.

**assets** Things of value owned by a person or an organization.

**assume a loan** *See* loan assumption

**assumption balance** The remaining balance on a loan at the time of closing if the loan is being assumed by the buyer. The current lender provides this figure.

**automated underwriting** The evaluation of a mortgage loan application using predetermined formulas and credit scores. Fannie Mae's Desktop Underwriter performs automated underwriting.

**automated valuation** The use of computers and linear regression formulas to calculate the market value of property based on large numbers of comparable sales.

**before-tax cash flow (BTCF)** The amount of spendable income from an income property after paying operating expenses and debt service, but before the effect of income taxes.

**bilateral contract** A contract that requires both parties to perform, such as a sales contract.

**biweekly mortgage** A mortgage that requires that the borrower make payments every two weeks (26 payments per year). The payment is calculated by dividing the monthly mortgage payment by two. The effective result is that the borrower makes 13 monthly payments per year.

**body language** Nonverbal communication expressed by the position of the body, hands, arms, or legs, or by facial expressions.

**Brokerage Disclosure to Buyer** The disclosure form that is required when a licensee meets a potential buyer but has an agency or transaction broker relationship with a seller.

**Brokerage Disclosure to Seller (FSBO)** The disclosure form that is required when a licensee meets an unrepresented seller of a property the licensee's buyer wishes to purchase. Since the licensee has an agency or transaction broker relationship with the buyer, this form is used to disclose that relationship to the seller and could be used to make the seller a customer.

**buyer agency** The fiduciary relationship between a buyer and the buyer's single-agent broker.

**buyer brokerage agreement** An agreement between a buyer and a broker for the broker to provide services to the buyer for compensation. The broker may be acting as a single agent or a transaction broker.

**buyer's broker** The broker representing the buyer. The buyer's broker is often appointed through an exclusive right-to-buy contract. This broker will be responsible for the buyer's closing statement at closing. Sometimes called the selling broker.

**calculated interest rate** The interest rate in an adjustable-rate mortgage that is calculated by adding the margin to the index.

**canvassing** Prospecting for buyers or sellers by telephoning or walking door-to-door.

**cap** The maximum amount that an interest rate can increase per year or during the life of a loan.

**capitalization rate** The net operating income divided by the property value. A percentage representing the return on the investment, assuming the property was purchased for cash.

**cash flow report** A property manager's monthly report to the owner, showing cash receipts and cash disbursements of an income property.

**certificate of taxes due** A certificate or report prepared by a county treasurer confirming the current status of general property taxes and governmental special assessments for a particular property.

**certified check** A check issued by a bank guaranteeing payment. The buyer is usually required to bring a certified check to closing by most title closing agents to speed disbursement at closing.

**Certified Property Manager (CPM)** A professional designation awarded by the Institute of Real Estate Management (IREM) to a property manager who has successfully completed required education and experience.

**closing** The consummation of the real estate transaction in which the seller delivers legal title to the buyer in exchange for the agreed payment or other consideration. Closing involves both the financial and the legal aspects of carrying out the agreement, created by the Contract to Buy and Sell, between the buyer and seller.

**collateral** Something of value given as security for a debt. In real estate, the mortgage or deed of trust pledges the property as collateral for the repayment of the loan.

**Colorado tax payment schedule** In Colorado, general property taxes become a lien on the property on January 1 in arrears. They may be paid without penalty either the entire amount no later than April 30 or two equal payments with the first on or before the last day in February and the balance not later than June 15.

**commission** Compensation for professional services that is usually calculated as a percentage of the property's sales price.

**Commission rules** Require a broker-associate who is either an agent or a transaction broker working with a seller to disclose that brokerage relationship to a potential buyer in writing before providing brokerage services to the buyer.

**comparable property** A similar property in the same market area that may be used to help estimate the value of the property being appraised.

**comparative market analysis (CMA)** Similar to the comparable sales approach used by appraisers, but usually less detailed. Used by broker-associates to estimate the most likely selling price of properties they are listing or selling.

**computer valuation** The use of computers and linear regression formulas to estimate the market value of property based on large numbers of comparable sales.

**Consumer Credit Protection Act** A federal statute that controls the information a lender may obtain and consider in qualifying consumer mortgage loan applicants.

**contingency** A condition in a contract that, unless satisfied, may make the contract voidable by one of the parties.

**contract** An agreement between two or more parties to do or not do a specific act.

**contraction** The phase of a business cycle that begins after a recession when economic conditions worsen.

**contract service** A property maintenance service performed by an individual or a company not in the employ of the property manager.

**Contract to Buy and Sell** *See* sales contract.

**conventional loan** A loan with no government guarantee or mortgage insurance.

**cooperating broker** A broker working with a buyer (or tenant). The cooperating broker often receives compensation through an agreed division of the listing broker's transaction commission.

**cooperative sale** Sale of a property by a broker who is not the listing broker. Normally, commissions are split between the two brokerage firms.

**corrective maintenance** The repairs to a building's structure and equipment following breakdown.

**counteroffer** A substitution for the original offer made by the offeree, who changes the price or terms offered and sends it back to the offeror. The original offer is terminated. The original offeree becomes the offeror.

**credit (seller or buyer)** In closings, a credit is an amount received by a party or an amount such as a loan that the buyer does not bring to the closing in cash. A credit is "good" for the cash position of the party at closing.

**credit scoring** A method of credit reporting using a numeric score. A higher score reflects a better credit history.

**curb appeal** The impression, good or bad, that is made when a person first looks at a house from the street.

**customer** A person who works with a broker-associate and is not represented in the transaction. The person must sign a disclosure stating that he agrees to the relationship.

**cycle** Periodic fluctuations of the overall economy, or any part of the economy, between good times and bad. The four parts of a general cycle are expansion, recession, contraction, and recovery.

**cyclic fluctuation** Part of an economic cycle.

**database** A listing of information in a form that allows easy manipulation and reporting. It is also the name for a software program that makes the organization of information easier.

**debit (seller or buyer)** In closings, a debit is an amount charged to a specific party or a sum the party will not receive in cash at closing. A debit is "bad" for the cash position of the party at the time of closing.

**deed of trust** A deed of trust creates a lien on a property to secure a note. In Colorado, the deed of trust is administered by a public trustee. The deed of trust will be accompanied by a promissory note; both are signed by the buyer.

**deferred maintenance** Maintenance that needs to be done, but has not been done for some reason, usually economic.

**deficit closing** A closing in which the seller receives insufficient money to pay all of the obligations. The seller would be required to bring money to the closing in order to deliver title to the property.

**designated broker** Under Colorado's designated brokerage law, the individual licensee (or team of licensed individuals) appointed by an employing broker to hold the brokerage relationship with a seller, landlord, buyer, or tenant. The designated broker may be a single agent or a transaction broker and is the only representative that is considered to have imputed knowledge (confidential information given to her by the buyer or seller) in the firm. Under Colorado law, no one else in the firm, including the employing broker, has any imputed knowledge.

**digital camera** A camera that does not use conventional film, but instead stores images in a memory chip in the camera, ready to be loaded into a computer for display or printing.

**disclosure** The revelation of information important to a transaction.

**discount points** *See* loan discount fee.

**documentary fee** In Colorado, this fee is paid upon recording any deed conveying title from a grantor to a grantee. The fee is one cent per \$100 of consideration paid for the property. Determine the fee by moving the decimal point four places to the left in the selling price.

**dual agent** An illegal arrangement whereby the broker tries to represent both the buyer and the seller in the same transaction.

**dynamic risk** Uninsurable risk, such as that of an economic downturn.

**earnest money** A deposit accompanying an offer to purchase that becomes earnest money (sometimes called good-faith money). The earnest money may be identified in a contract as liquidated damages that would be forfeited if the buyer breaches the contract.

**earnest money promissory note** A personal note presented by a buyer as a form of earnest money. If acceptable to the seller, the note is made out to the listing broker and presented for payment when due.

**effective gross income (EGI)** The amount of rent and other income actually collected by the owner. When preparing an income statement, vacancy and collection losses are deducted from potential gross income as factors. The balance after this subtraction is effective gross income.

**email** Electronic mail that is sent over the internet.

**Equal Credit Opportunity Act** A federal statute that controls the information a lender may obtain and consider in qualifying consumer mortgage loan applications.

**equity** The amount of the owner's portion of the property value after deducting mortgages and other liens.

**escrow account** An account maintained by a broker to hold and account for money belonging to others. The account must meet strict requirements of Real Estate Commission rules.

**ethical** The right thing to do. Usually a higher standard than legality.

**exclusive brokerage (exclusive agency) listing** A listing that requires that the owner pay the listing broker if the property is sold by any broker, but allows the owner to personally sell the property without being liable for a commission. Exclusive brokerage is used in Colorado, while exclusive agency is used in other states and may be seen on the national portion of the Colorado real estate licensing exam.

**exclusive right-to-sell listing** A listing that requires that the owner pay the listing broker no matter who sells the property. The broker is automatically the procuring cause of the sale.

**executed contract** A contract in which nothing else remains to be done. All requirements have been performed by the parties.

**executory contract** A contract in which part of the agreement remains to be done. It has not yet closed.

**exercised** Used in connection with an option contract. An option contract is a unilateral contract until the optionee agrees to purchase and is then said to have exercised the option; the contract is now considered to be bilateral.

**expansion** The phase of a business cycle that begins after a recovery when economic conditions improve.

**express contract** An oral or written agreement where the words specifically describe the intent of the parties.

**Fair Housing Act** Federal law that prohibits discrimination in housing based on race, color, religion, sex, national origin, familial status, or handicap.

**fallback list** A list of properties similar to the property being advertised that can be used by the licensee if the advertised property does not appeal to the person responding to the ad.

**false or misleading statement** In real estate, a statement made by a licensee or party in a real estate transaction that is not factual.

**farm** A geographic area selected for special prospecting attention by a real estate licensee.

**fee** Compensation, either as a fixed dollar amount or a percentage of the sale price.

**FHA loan** A loan that includes FHA mortgage insurance. The lending program is regulated by the Federal Housing Administration (FHA) and the borrower pays a mortgage insurance premium (MIP).

**FHA mortgage insurance** An insurance program sponsored by the government and administered by HUD that insures lenders against default by a borrower. The mortgage insurance premium is paid by the borrower.

**FICO score** A proprietary numeric credit score used to evaluate a prospective borrower, developed by Fair Isaac Corporation.

**fiduciary relationship** A relationship of trust and confidence between an agent and a principal.

**first deed of trust** A deed of trust creating a lien to secure a real estate loan. A first deed of trust has priority over other private liens based on its date and time of recording.

**fixed-rate mortgage** A loan secured by real estate that has the same rate of interest for the life of the loan.

**flood plain certification** Flood damage is excluded from normal homeowner hazard insurance. Lenders may require additional flood insurance if a property is located in a recognized flood plain. The certification service confirms whether the property is located in a flood plain. The cost of the service is normally a buyer's closing cost.

**for rent by owner** An owner who attempts to rent his own property without using a broker.

**for sale by owner** An owner who attempts to sell his own property without using a broker.

**funding fee** A charge levied by the Department of Veteran's Affairs to veterans who use VA loans.



**good funds** Banking rules define certain types of funds as redeemable for cash immediately at any bank. Colorado law dictates that a closing may only be done when all funds at closing are good funds. Cashier's checks, teller's checks, and federal funds wire transfers are the most common forms used for real estate closings.

**gross domestic product (GDP)** The sum total of goods and services produced by the United States. The four major components of GDP are consumption, investment, government purchases, and net exports.

**hazard insurance** The homeowner's insurance policy that protects against losses from fire and other hazards.

**hold harmless** Clause in a listing agreement whereby the seller warrants that all information given to the broker is correct; also called warranty of owner.

**homeowners association (HOA)** The association established by the declaration documents of a common-interest community. The association has the authority to levy mandatory assessments for maintenance of common elements in the community and to enforce unpaid levies with a lien on the property.

**implied contract** An agreement not spelled out in words, where the agreement of the parties is demonstrated by their acts and conduct.

**index** An indicator beyond the control of a lender to which the interest rate on an adjustable-rate mortgage is tied.

**Institute of Real Estate Management (IREM)** A national organization of property managers affiliated with the National Association of REALTORS®.

**internet** The global network of computers connected by cable and phone lines.

**jargon** A word or expression related to a specific vocation that a layperson may not understand.

**k** The symbol for the annual mortgage constant, calculated by dividing the annual payment of principal and interest by the original amount of the loan.

**keysafe** *See* lockbox.

**laser printer** A printer using a toner bonded to the paper by laser and heat.

**lender reserve (impound) account** An account established by a lender to hold money collected in advance with monthly loan payments to pay later bills for property taxes and insurance. The funds belong to the borrower until the obligation is paid by the lender on behalf of the borrower.

**leverage** The use of borrowed money with the intent to increase the investor's return on the cash invested. If the return on the investment is greater than the interest rate paid by the borrower, the owner has positive leverage.

**liabilities** Amounts owed by a person.

**listing agreement** An agreement between a seller and a broker whereby the seller agrees to pay the broker a commission if the broker is successful in selling the property.

**listing broker** The broker hired by the seller to market a property. The listing broker is normally appointed through an exclusive right-to-sell contract. This broker will be responsible for the seller's closing statement at closing.

**listing presentation** A "sit down at the dining room table" discussion at which the licensee builds rapport with a seller, explains the pricing process, and asks for the listing.

**loan assumption** With a lender's approval a buyer may be allowed to "assume and agree to pay" the seller's existing loan. The buyer then becomes responsible for the terms of the original agreement and the seller is relieved of liability.

**loan constant** Calculated by dividing the annual payment of principal and interest by the original amount of the loan.

**loan discount fee** This fee is also called points or discount points. It is a percentage of the loan amount collected as advance payment of interest. A buyer may use points to get a lower interest rate on the loan. A lender views a discount fee as a way to increase the income or yield on the loan. The amount of the fee will depend on the availability of mortgage money in the marketplace.

**loan origination fee** The administrative fee charged by a lender for the processing of a loan application. Also called a loan origination fee, it is usually quoted as a percentage of the loan amount. This fee is like the lender's commission.

**loan processing procedures** Steps taken by a lender to ensure that underwriting and documentation of a mortgage loan are done in a manner that reduces the lender's exposure to loss.

**loan underwriting** The evaluation of risk when a lender makes a mortgage loan to reduce the lender's exposure to loss.

**loan underwriting fee** One of a number of specific fees charged by some lenders to offset specific expenses and increase their income or yield on a loan. Some of these fees are referred to as junk fees.

**lockbox** Also called a key safe, a secure box holding the key to the home, usually attached to a door handle. It allows licensees who are members of the MLS easy access to the property by using a special access key to the box.

**margin** The additional percentage added to the index on an adjustable-rate mortgage, resulting in the calculated interest rate.

**marketing knowledge** A licensee's knowledge of the sales process, including the psychology of selling, advertising, personal marketing, and prospecting.

**material fact** An important fact that may affect a buyer's decision to buy or a seller's decision to sell. Licensees must disclose facts that materially affect the value of residential property.

**MIP** *See* mortgage insurance premium.

**misrepresentation** A false or misleading statement, made intentionally or unintentionally, or the failure to disclose a material fact.

**mortgage insurance** An insurance policy that protects a lender against default by the borrower. The premium is normally paid by the borrower.

**mortgage insurance premium (MIP)** The amount paid by a borrower for insurance that protects the lender against loss in case of the borrower's default. MIP is most commonly used when referring to FHA mortgage insurance.

**mortgagee title insurance policy** A policy of title insurance to benefit a lender (mortgagee). The policy covers only the remaining balance on a loan and ceases when the loan is paid off. The premium is normally paid by the borrower.

**negative amortization** A situation, usually occurring under a graduated payment mortgage, where the payment on the loan is less than the amount required to pay the accrued interest. The unpaid interest is added to the principal balance of the loan and the loan balance gradually increases.

**negotiable** Open to discussion; the status of any item with a checkbox on the Contract to Buy and Sell.

**net operating income (NOI)** The income from an investment property remaining after operating expenses have been paid from the effective gross income.

**net proceeds** The amount remaining to the seller after paying off the mortgage and expenses of a sale.

**net worth** The amount remaining when liabilities are subtracted from assets.

**new construction maintenance** Work done on an income property designed to enhance the property's appeal to tenants. Includes adding new wallpaper, carpeting, and light fixtures.

**nonverbal communication** Unspoken communication expressed by the position of the body, hands, arms, or legs, or by facial expressions. Commonly called body language.

**notary** A notary public is an official authorized to receive acknowledgment of a signature and attest that it was given willingly by the party identified in the document.

**notary fee** The fee for notary service. This fee is paid by the party whose signature is acknowledged before the notary.

**open listing** A nonexclusive agreement in which a seller agrees to pay a broker if the broker sells the property. The broker is not paid if the seller or another broker sells the property.

**operating expenses (OE)** Costs of operating an income property. Includes property taxes, maintenance, insurance, payrolls, and reserves for replacements.

**opinion of value** A broker's price opinion, usually based on a comparative market analysis.

**option contract** An agreement that allows one party to buy, sell, or lease real property for specified terms within a specified time limit.

**paid in advance** Prepaid. A bill or obligation paid ahead of the time the service or product is delivered.

**paid in arrears** A bill or obligation paid after the service or product is delivered.

**paperless mortgage** A mortgage that is signed electronically, using digital signatures.

**passive prospecting** A method of prospecting that does not include direct face-to-face or telephone conversations. Advertising and direct mail are examples of passive prospecting.

**performance** The completion of a contract's requirements.



**PITI payment** The payment required of a borrower that includes principal, interest, taxes, and insurance.

**point** A lender's charge to the borrower that increases the lender's yield. One point is equal to 1% of the loan amount.

**potential gross income (PGI)** The total annual income a property would produce if it were 100% occupied, with no vacancy or collection loss.

**power prospecting** A type of prospecting that seeks to make contact with many more buyers and sellers and that results in much higher income levels.

**preclosing walk-through inspection** An inspection of the house by the buyer, done sometime before the sale closes, to determine that the property is in the same condition as it was when the contract was signed and to ensure that all required repairs have been completed.

**prequalification** The preliminary process during which a prospective lender evaluates the buyer's ability to obtain a mortgage loan. Most licensees want a buyer to be prequalified or preapproved before showing properties to that buyer.

**preventive maintenance** A work program designed to preserve the physical integrity of the premises and eliminate the more costly corrective maintenance.

**previewing properties** The activity a licensee uses to stay abreast of the market and to find specific properties to show to a prospective buyer.

**principal** (1) The person who enters into a fiduciary relationship with a single-agent licensee. (2) The amount of money remaining due on a mortgage loan.

**prioritize** To set up a list of activities in an order based on their importance.

**private mortgage insurance (PMI)** The amount paid by a borrower for insurance that protects the lender against loss in case of the borrower's default. Conventional lenders use the term private mortgage insurance; FHA mortgage insurance is called MIP.

**product knowledge** A licensee's familiarity with the real estate market and specific properties available for sale.

**professional ethics** A body of accepted codes of behavior for a specific industry.

**profit and loss statement** A detailed report of the income and expenses of an investment property over a stated period of time.

**property characteristics** The features of a property that are used as a basis of comparison in an appraisal or comparative market analysis.

**proration** In a closing, ongoing expenses of the property, such as property taxes, are divided between the parties in proportion to the period of ownership of the parties. Proration is the calculation of the appropriate amount and accounting for it in the closing documents.

**qualifying** The process used by a licensee to determine whether to spend time working with a buyer or seller. For example, a buyer would first be qualified financially, then based on motivation to buy.

**quality of income** A lender's analysis of factors that reveal the likelihood of the borrower's income continuing over a long period of time.

**quantity of income** The total amount of a borrower's income from all sources.

**random changes** Irregular fluctuations of the economy caused by factors such as legislative and judicial decisions, wars, and weather.

**Real Estate Settlement Procedures Act (RESPA)** A federal law requiring disclosure of loan closing costs in certain real estate financial transactions.

**Real Property Transfer Declaration (TD-1000)** A form required by law to be submitted with the recording of a transfer deed and signed by the grantor or the grantee. Closing companies prepare the form for signature at the closing. The form provides information to the county assessor for use in ensuring fair and uniform assessments for real property taxation.

**realty tax service** A computerized service that keeps track of the general property tax obligations for a lender who collects tax and insurance monthly into reserve accounts. For a onetime fee paid at closing, the service ensures that taxes are paid to the right county on the correct schedule.

**recession** Two successive quarterly declines in the gross domestic product (GDP). This is the point at which economic activity has peaked and will be followed by a contraction.

**reconcile** To use two sets of records to ensure account figures are accurate and in agreement with each other.

**reconciliation** The final step in the appraisal process before the report is prepared. The correlation of property values derived from each of the three appraisal approaches into a single estimate of value.

**recording** A copy of a document is placed in the public record by the county clerk and recorder. Recording creates legal notice (constructive notice) of the contents of the document, such as a deed conveying title or a lien encumbering the property.

**recovery** Two successive quarterly increases in the gross domestic product (GDP). This is the point at which economic activity has bottomed and will be followed by expansion.

**refinancing** Placing a new mortgage on a property to replace another mortgage.

**release of deed of trust** When a real estate loan secured by a deed of trust is fully paid, the deed of trust continues to appear in the public record. Recording a release of deed of trust shows that the lien has been released.

**reserves for replacements** A portion of an investment property's income that is set aside to pay the cost of replacing major building components when necessary.

**resident manager** A salaried individual employed for specific management functions for a single investment property.

**rider** An attachment to a contract.

**routine maintenance** The most common maintenance performed on an investment property, such as grounds care and housekeeping.

**sales contract (Contract to Buy and Sell)**

A bilateral agreement in which a buyer agrees to purchase a seller's property at a specified price and under particular terms.

**scanner** A computer device that allows the user to copy a document or picture for use in a computer.

**scrivener** A term from English common law referring to a person hired to complete forms exactly as directed. The scrivener is not responsible for the form; the party hiring the scrivener retains full responsibility.

**seasonal variation** Changes in the economy (for example, winter tourism in Colorado) that recur at regular intervals at least once a year.

**second deed of trust** A deed of trust recorded later than the first deed of trust.

**seller agency** The relationship of a single agent and his principal, the seller.

**seller-carry financing** A loan from the seller to the buyer to finance part of the purchase price of a property. The seller generally lends part of the equity she would normally have received in cash at closing.

**Seller's Net Proceeds Form** A form used to show the seller's equity, expenses, and prorations, as well as the net amount the seller is estimated to receive as proceeds from the sale of the property.

**Seller's Property Disclosure Form** A form designed for disclosure to a buyer of any property defects. The form is normally signed by the seller, and the buyer signs a receipt of the disclosure.

**selling broker** *See* buyer's broker.

**servicing the listing** The actions of a licensee who stays in touch with a seller regularly, getting feedback from licensees who have shown the property, sending the seller copies of advertisements, and generally keeping the seller informed of the marketing efforts.

**settlement services** The collection of services provided by a broker or closing company to complete a Contract to Buy and Sell; pay bills related to the closing; prepare, record, and deliver documents required by the transaction; and ensure an orderly transfer of marketable title.

**settlement statement** Colorado Real Estate Commission approved form SS60. The form provides a two-column summary of the financial aspects of the closing for either a buyer or a seller. The form is marked at the top to indicate the party to whom it applies. The form is mandatory if a broker performs the closing through the brokerage office.

**show list** A selected inventory of apartments that are available for inspection by prospective tenants.

**single agent** A broker who represents either the seller or the buyer in a real estate transaction, but not both.

**single entry** An entry on a settlement closing worksheet that has no offsetting entry. Most single entries are debits for an expense charged to one party of the transaction and paid on behalf of that party by the lender on a new loan.

**six-column settlement closing worksheet** (also closing worksheet for real estate settlement) The six-column closing worksheet is provided by the Colorado Real Estate Commission. It is not mandatory but is available for a broker's convenience in calculating the financial aspects of a closing.

**software** Computer programs designed specifically to perform specialized functions.

**special assessment** A special improvement cost levied by a government entity for improvements benefiting a limited area. The owners of properties that benefit pay a proportionate share, often based on street frontage. Typical improvements could be street lighting or new curb and gutter.

**specific cycles** Wavelike movements similar to business cycles that occur in specific sectors of the general economy, such as the real estate market.

**spreadsheet** A software program using columns and rows that allows the user to create formulas that act on the numbers stored in the spreadsheet. A change in one amount will change other numbers or totals in the spreadsheet, making what-if scenarios simple.

**square footage disclosure** A required disclosure for all residential property in Colorado if the square footage of the property is listed in any sales information. The listing broker must specify how she measured the property or, if she used another source, that source must be identified.

**static risk** Risk that is quantifiable and insurable. For example, the risk of fire is a static risk. Fire insurance will transfer the risk from the owner to the insurance company.

**statute of frauds** A body of law that requires certain contracts, such as those for the sale of real property, to be written.

**steering** The illegal, discriminatory act of a sales associate who brings buyers into an area based on the racial or ethnic makeup of the neighborhood.

**subject property** The property being appraised.

**targeted strangers** Persons not known to a licensee who are qualified as prospects by income, occupation, or residence address.

**tax certificate** *See* certificate of taxes due.

**TD-1000 Form** *See* Real Property Transfer Declaration.

**technical knowledge** The knowledge needed by licensees to properly conduct their business that relates to filling out contracts, preparing seller's proceeds estimates, doing comparative market analyses, and so forth.

**time is of the essence** A contract clause that requires strict compliance with all dates and times specified in the contract. If a party fails to perform some act by the time specified, the person may be in default.

**time management** The organization of a person's day to maximize efficiency. It includes planning, scheduling, and prioritizing.

**title insurance** A guarantee to reimburse a loss arising from defects in title or liens against real property.

**title insurance premium** The cost of the title insurance policy. This amount is paid at closing and is a onetime charge.

**to-do list** A daily list, usually designed in priority order, of tasks to be completed that day.

**transactional characteristics** The factors related to a real estate transaction itself, such as time of sale and financing terms.

**transaction broker** A licensee who has limited representation to the buyer, the seller, or both in a transaction. Instead of being an advocate for the buyer or the seller, the licensee is working for the contract. If the licensee is representing both sides in a single transaction, the licensee must be a transaction broker in Colorado.

**trust account** *See* escrow account.

**Truth in Lending Act** A federal law that requires that lenders inform consumers of exact credit costs before they make their purchases.

**unilateral contract** A contract in which only one of the parties is required to perform, such as an option contract. The optionor must sell if the optionee exercises the option, but the optionee is not required to buy.

**valid contract** An agreement that complies with all the essentials of a contract and is binding on all parties.

**VA loan** A loan guaranteed by the Department of Veterans Affairs. If a borrower defaults on the loan, the VA guarantees that the lender will not lose money in a foreclosure sale. The loan is available as a benefit to eligible veterans of military service.

**verbal communications skills** The ability to speak effectively one-on-one or in a group presentation.

**voidable contract** An agreement that may be canceled by the party who would be damaged if the contract were enforced. Minors, fraud, duress, and misrepresentation make contracts voidable.

**void contract** An agreement that is not binding on either party.

**written communication skills** The ability to communicate effectively in letters, emails, and other documents.



Real Estate Settlement Closing Worksheet

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price						
2. Deposit, Paid to:						
3. Deed of Trust, Payable to:						
4. Deed of Trust, Payable to:						
5. Deed of Trust, Payoff to:						
6. Interest on Loan Assumed						
7. Owner Title Insurance Premium						
a. Extended Title Insurance						
b. Mortgagee's Policy						
8. Closing Fee						
9. Notary Fee						
10. Title Exam by Buyer Attorney						
11. Recording: Warranty Deed						
12. Deed of Trust						
13. Release						
14. Other						
15. Documentary Fee						
16. Certificate of Taxes Due						
17. Taxes for Preceding Year(s)						
18. Taxes for Current Year						
19. Tax Reserve						
20. Special Taxes/Assessments						
21. Personal Property Taxes						
22. Notary Fee Paid by Lender						
23. Premium for New Insurance						
24. Hazard Ins. Reserve						
25. FHA Mortgage Ins. Assumed						
26. FHA Mortgage Ins. Reserve						
27. Loan Origination						
28. Loan Discount Points						
29. Interest on New Loan						
30. Survey						
Credit Report						
31. Appraisal Fee						
32. Water and/or Sewer						
33. Rents						
34. Security Deposits						
35. Loan Transfer Fee						
36. Loan Payment Due						
37. Broker's Fee						
38. Seller's Attorney						
39. Net Loan Proceeds						
Subtotals						
Balance Due To/From Seller						
Balance Due To/From Buyer						
TOTALS						

Real Estate Settlement Closing Worksheet

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price						
2. Deposit, Paid to:						
3. Deed of Trust, Payable to:						
4. Deed of Trust, Payable to:						
5. Deed of Trust, Payoff to:						
6. Interest on Loan Assumed						
7. Owner Title Insurance Premium						
a. Extended Title Insurance						
b. Mortgagee's Policy						
8. Closing Fee						
9. Notary Fee						
10. Title Exam by Buyer Attorney						
11. Recording:     Warranty Deed						
12.     Deed of Trust						
13.     Release						
14.     Other						
15. Documentary Fee						
16. Certificate of Taxes Due						
17. Taxes for Preceding Year(s)						
18. Taxes for Current Year						
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20. Special Taxes/Assessments						
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24. Hazard Ins. Reserve						
25. FHA Mortgage Ins. Assumed						
26. FHA Mortgage Ins. Reserve						
27. Loan Origination						
28. Loan Discount Points						
29. Interest on New Loan						
30. Survey						
Credit Report						
31. Appraisal Fee						
32. Water and/or Sewer						
33. Rents						
34. Security Deposits						
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36. Loan Payment Due						
37. Broker's Fee						
38. Seller's Attorney						
39. Net Loan Proceeds						
Subtotals						
Balance Due To/From Seller						
Balance Due To/From Buyer						
TOTALS						

## Real Estate Settlement Closing Worksheet

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price						
2. Deposit, Paid to:						
3. Deed of Trust, Payable to:						
4. Deed of Trust, Payable to:						
5. Deed of Trust, Payoff to:						
6. Interest on Loan Assumed						
7. Owner Title Insurance Premium						
a. Extended Title Insurance						
b. Mortgagee's Policy						
8. Closing Fee						
9. Notary Fee						
10. Title Exam by Buyer Attorney						
11. Recording: Warranty Deed						
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13. Release						
14. Other						
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Real Estate Settlement Closing Worksheet

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price						
2. Deposit, Paid to:						
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4. Deed of Trust, Payable to:						
5. Deed of Trust, Payoff to:						
6. Interest on Loan Assumed						
7. Owner Title Insurance Premium						
a. Extended Title Insurance						
b. Mortgagee's Policy						
8. Closing Fee						
9. Notary Fee						
10. Title Exam by Buyer Attorney						
11. Recording:     Warranty Deed						
12.                 Deed of Trust						
13.                 Release						
14.                 Other						
15. Documentary Fee						
16. Certificate of Taxes Due						
17. Taxes for Preceding Year(s)						
18. Taxes for Current Year						
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20. Special Taxes/Assessments						
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34. Security Deposits						
35. Loan Transfer Fee						
36. Loan Payment Due						
37. Broker's Fee						
38. Seller's Attorney						
39. Net Loan Proceeds						
Subtotals						
Balance Due To/From Seller						
Balance Due To/From Buyer						
TOTALS						



## Real Estate Settlement Closing Worksheet

	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
1. Selling Price						
2. Deposit, Paid to:						
3. Deed of Trust, Payable to:						
4. Deed of Trust, Payable to:						
5. Deed of Trust, Payoff to:						
6. Interest on Loan Assumed						
7. Owner Title Insurance Premium						
a. Extended Title Insurance						
b. Mortgagee's Policy						
8. Closing Fee						
9. Notary Fee						
10. Title Exam by Buyer Attorney						
11. Recording: Warranty Deed						
12. Deed of Trust						
13. Release						
14. Other						
15. Documentary Fee						
16. Certificate of Taxes Due						
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29. Interest on New Loan						
30. Survey						
Credit Report						
31. Appraisal Fee						
32. Water and/or Sewer						
33. Rents						
34. Security Deposits						
35. Loan Transfer Fee						
36. Loan Payment Due						
37. Broker's Fee						
38. Seller's Attorney						
39. Net Loan Proceeds						
Subtotals						
Balance Due To/From Seller						
Balance Due To/From Buyer						
TOTALS						



Real Estate Settlement Closing Worksheet Helper

	All Closings		Assumable		New Loan	
	SELLER		BUYER		BROKER	
	Debit	Credit	Debit	Credit	Debit	Credit
Check Out						
1. Selling Price: always use—what the closing is all about (Line 15)		XX				
2. Deposit, Paid to: money the buyer gave the broker						
3. Deed of Trust, Payable to: lender in assumable (Line 6)	XX				XX	
3. Deed of Trust, Payable to: gross loan amount—single entry						
4. Deed of Trust, Payable to: seller-carry loan	XX					
5. Deed of Trust, Payoff to: new loan, single entry	S					
6. Interest on Loan Assumed: seller will owe portion of the month of closing	Prorate XX			Prorate XX		
7. Owner's Title Insurance Premium: seller agrees to pay per contract	XX					XX
a. Extended Title Insurance: negotiable charge per the contract	????					XX
b. Mortgagee's Policy: buyer cost in new loan, single entry						
8. Closing Fee: split between the parties—negotiable charge per contract	??					XX
9. Notary Fee: charge person who signs the document	Warranty					XX
10. Title Exam by Buyer's Attorney: buyer owes; broker will pay the bill				Deed of trust		XX
11. Recording: warranty deed: always buyer's—new loan, single entry				XX		XX
12. Deed of Trust: always a buyer fee if one is used				S or XX		XX
13. Release: seller fee to clear title—new loan, single entry	S			S or XX		XX
15. Documentary Fee: move decimal four places to the left in sales price				XX		XX
16. Certificate of Taxes Due: buyer debit—to find what the seller might owe				XX		XX
17. Taxes for Preceding Year(s): note if the seller has paid and the amount	If owed					Only if not paid
18. Taxes for Current Year: seller will owe buyer prorated share	Prorate XX			Prorate XX		
19. Tax Reserve: lender impound—buyer charge, single entry				S		
20. Special Taxes/Assessments: if seller agrees to pay, charge seller	XX					XX
21. Personal Property Taxes: buyer fee if charged				XX		XX
22. Notary Fee Paid by Lender: buyer charge—new loan, single entry				S		
23. Premium for New Insurance: charge buyer for new policy				XX		XX
24. Hazard Ins. Reserve: lender impound; buyer charge—new loan, single entry				S		
27. Loan Origination: charge to buyer—new loan, single entry				S		
28. Loan Discount Points: charge to buyer—new loan, single entry				S		
29. Interest on New Loan: buyer will owe prorated share for the month of closing				Prorate ??		
31. Appraisal Fee: charge buyer—new loan, single entry				S		
32. Water and/or Sewer: prorate month of closing per bill	Prorate ??	Prorate ??		Prorate ??		XX - If not paid
33. Rents: prorate—seller will always owe buyer for buyer's share	Prorate XX			Prorate XX		
34. Security Deposits: transfer full amount from seller to buyer	XX			XX		
35. Loan Transfer Fee: charge buyer fee to transfer in assumable loans				XX		XX
36. Loan Payment Due: seller will owe; credit broker to pay	XX					XX
37. Broker's Fee: seller will owe the brokerage	XX					XX
38. Seller's Attorney: seller owes; broker will pay the bill	XX					XX
39. Net Loan Proceeds: broker deposit, to pay the other new loan bills					S	



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